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leader

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Politics this week

Nov 2nd 2006
From The Economist print edition

America's political parties rallied their core supporters as the electorate prepared to vote in the **mid-term elections** on November 7th. George Bush hit the trail to rail against gay marriage and terrorists in Iraq. He also chastised Senator John Kerry, who is not up for election, for his gaffe that the uneducated get "stuck in Iraq". With polls forecasting that the Republicans will lose the House of Representatives, but predicting the outcome in the Senate with less certainty, Democrats continued with their mantra that the Iraq war has made America unsafe. See article

Authorities said arson was the cause of a **forest fire** near Palm Springs, California, that burned more than 40,000 acres. Five firefighters were killed and dozens of properties destroyed.

On the frontline

AP

Iraq's unrelenting violence included two particularly vicious bomb explosions in Sadr City, a Shia district of Baghdad. One killed at least 15 people, including four children, at a wedding; the other at least 30 people, mainly labourers looking for work.

Israel launched a "major operation" in the northern **Gaza Strip**, reoccupying the town of Beit Hanoun with tanks and helicopter gunships. See article

Meanwhile, talks continued about **prisoner exchanges** to retrieve the Israeli soldier held captive in Gaza and the two held captive in Lebanon. Egyptian officials negotiated with a Hamas delegation in Cairo; and Hizbullah's leader, Hassan Nasrallah, said the UN was negotiating between Israeli and Hizbullah officials.

Tony Blair sent a senior foreign-policy adviser, Sir Nigel Sheinwald, to **Syria** to find out whether President Bashar Assad could be tempted into playing a more pro-Western role. America meanwhile warned Syria to cease attempts to destabilise the government of Lebanon. See article

Around 70 people were killed by floods in **Ethiopia's** eastern Ogaden region after a river burst its banks. In August, flooding killed an estimated 900 people in the country.

A **Nigerian** passenger aircraft crashed after take-off from the capital Abuja, killing 96 people. It was the country's third civilian air disaster in a year. See article

Congo's presidential run-off election on October 29th passed off relatively peacefully. Early indications show a surprisingly close contest between the incumbent president, Joseph Kabila, and his challenger, Jean-Pierre Bemba. See article

No temporary solution

Violent clashes erupted across **Bangladesh** as an interim government, to oversee elections due in January, took office. The opposition feared that the outgoing government led by Khaleda Zia, the prime minister, might try to rig the elections through a biased interim administration. See article

Just three weeks after testing a nuclear device, **North Korea** announced that it would rejoin multilateral talks on ending its nuclear-weapons programme. The breakthrough came after secretly arranged talks with America and China in Beijing. See article

Protests took place in **Pakistan** after the army attacked a *madrassa* in the tribal area of Bajaur and killed at least 80 people it said were training as terrorists. Locals said many of the dead were children and that pilotless American drones had begun the attack. See article

Two days of talks in Geneva between **Sri Lanka's** government and Tamil Tiger rebels ended with no progress towards fixing their battle-scarred “ceasefire”.

Mitteleuropa

A summit in Berlin between **Germany and Poland** did little to resolve bilateral tensions over gas pipelines and German property claims dating from the aftermath of the second world war. The personal relationship between Germany's Angela Merkel and Poland's Jaroslaw Kaczynski was at least cordial, however.

One year after the riots in **France's** troubled suburbs, another spate of vehicle burnings, especially of buses, took place. In Marseille, a female bus passenger was left badly burnt and fighting for her life. See article

More than 70 Muslim workers at **Paris airport** were stripped of their security clearance. Some were reported to have visited terrorist training camps in Afghanistan and Pakistan. See article

Reuters

Serbian voters approved a new constitution that declares Kosovo to be an integral part of Serbia. A fresh election will probably be held in December, but Kosovo is still likely to win independence next year. See article

Catalonia held its first regional election since being granted more autonomy by the Spanish government under a new statute. The conservative nationalist CiU party won most seats, but it will take weeks before a new coalition government is formed in Barcelona.

Sir Nicholas Stern, the head of Britain's government economic service and a former chief economist at the World Bank, published a report on the economics of **climate change**. It concludes that if greenhouse-gas emissions continue on their current path, the cost could range between 5-20% of global output over the next 100-200 years. See article

Lucky Lula

Reuters

Brazil's left-of-centre president, Luiz Inácio Lula da Silva, won a second term by a landslide. He gained 61% of the vote in a run-off ballot, against 39% for Geraldo Alckmin, his centre-right opponent. Lula said he would seek to raise economic growth and cut the gap between rich and poor. See article

In a victory for **Bolivia's** socialist president, Evo Morales, ten foreign energy companies signed new contracts that grant majority ownership to the state and will quadruple government tax revenues from energy. Mr Morales also postponed previous plans to nationalise Bolivia's mines. See article

Thousands of federal police retook the centre of the southern **Mexican** city of Oaxaca, which had been occupied by protesters for five months. Congress called on the state's governor to step down. See article

At least 16 policemen were killed in a homemade mortar attack by FARC guerrillas on a rural police station in north-west **Colombia**.

After 47 rounds of voting in which **Guatemala** regularly beat **Venezuela** but failed to secure a two-thirds majority, both countries withdrew and agreed to support **Panama** to represent Latin America in a rotating seat at the UN Security Council.

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Business this week

Nov 2nd 2006
From The Economist print edition

Preliminary findings by the federal agency that investigates industrial chemical accidents in America rebuked **BP** for “the drastic effects of corporate cost-cutting” that led to last year's explosion at the oil company's refinery at Texas City. The investigators described a series of lapses underpinned by “cost pressures” that led to the blast, which killed 15 people and damaged BP's reputation. The company has settled with most of those who were injured or lost relatives in the accident, but the findings, which BP questions, may prove pertinent if there is a criminal trial. See article

Investigations widened on both sides of the Atlantic into the latest allegations of **price-fixing among chipmakers**, which this time focus on fast-memory SRAM chips. Sony said it was co-operating with an inquiry by America's Justice Department into industry-wide practices. Meanwhile, European regulators raided the offices of several chipmakers as part of their investigations. One of the companies reportedly targeted was Samsung, which was fined $300m last year by America after admitting to price-fixing in slower DRAM chips.

Google's buying spree continues. The firm announced it had acquired a company that specialises in building wiki webpages. **JotSpot's** products enable multiple users to collaborate on the internet on websites such as blogs, and on corporate intranets.

Changing drug habits

CVS, America's biggest retail drugs chain, agreed to merge with **Caremark**, a company that offers pharmaceutical services to health-care and insurance firms. The deal, valued at $21 billion, adjusts the focus of CVS's core business from pharmacy retail, in which Wal-Mart has become increasingly competitive on generic-drug prices, to managing drug-benefit plans. See article

Rinker, an Australian building-materials company, rejected a $12.8 billion takeover offer from Mexico's **Cemex**, the world's biggest maker of cement. Rinker's share price, which had been declining recently in relation to the slowdown in America's housing market, from which it derives the bulk of its earnings, surged on Sydney's stockmarket.

There was some fairly positive news from America's two biggest carmakers. **General Motors** and **Ford** said their auto sales in the United States rose in October by 22% and 8% respectively compared with a year earlier. With petrol prices tumbling from summer highs, the increase was particularly marked in sales of trucks and pick-ups. However, analysts cautioned that the comparison was skewed as October 2005 was a particularly dismal month and that sales fell compared with September 2006.

Schneider Electric, a company based in France and the world's biggest electrical equipment distributor, agreed to pay $6.1 billion for **American Power Conversion,** which specialises in maintaining “critical power” supplies to homes, businesses and hospitals during blackouts.

After more than a year of rumours about a possible deal, **CB Richard Ellis**, which manages real estate for companies, agreed to buy **Trammell Crow**, a smaller rival with more blue-chip clients, for $2.2 billion.

Less wealthy

UBS had a bad week. Amid reports that it was co-operating with a Securities and Exchange Commission investigation into the possible manipulation of American Treasury prices, the Swiss-based firm reported a 21% drop in net profit for the third quarter compared with a year ago, a stark contrast to the stellar

earnings posted by other big investment banks. UBS blamed the “market correction” that saw stockmarkets tumble in the early summer. See article

MasterCard, which listed on the stockmarket in May, issued its first results for a full quarter since it became a public company. The credit-card company's net profit rose by 82%, to $193m, compared with a year earlier, as consumers worldwide increased their use of plastic.

There was more evidence of a slowing American economy. GDP grew by 1.6% at an annual rate in the third quarter, the smallest increase since early 2003, with a sharp fall in home-building contributing to the sluggish performance. And with carmakers cutting production, the Institute for Supply Management's index indicated that manufacturing was growing at its slowest pace in three years.

Positive feelings

The European Commission's indicator of business and consumer **economic sentiment** in the euro area rose in October to its highest level in more than five-and-a-half years. Among the bigger countries in the currency block the uptick in optimism was particularly strong in Germany and France (where the unemployment rate is at a five-year low), but in Italy confidence fell.

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America's mid-term elections

The vultures gather

Nov 2nd 2006
From The Economist print edition

Whichever way you look at it, the Republicans deserve to get clobbered next week

“YOU have been sat here too long for any good you have been doing,” Oliver Cromwell famously declared, as he dissolved the Rump Parliament in 1653. If the polls are to be believed, American voters will say much the same to George Bush's Republicans when they vote in the mid-term congressional elections on November 7th. Although the Republicans may hold on to the Senate, where only 33 of the 100 seats are at stake, almost everyone expects that they will lose the majority they have held in the House of Representatives for the past 12 years. The scent of Republican defeat is in the air (see article).

Much of the blame rightly attaches to Mr Bush. He may not be on the ballot this year, but mid-terms are in large part a referendum on the president. Iraq, Katrina and Guantánamo have become globally recognised one-word indictments of an administration that has been simultaneously incompetent and cavalier. At home, he has failed to get government spending under control, especially when it comes to the “entitlements”, principally health care and pensions, that will overwhelm America's finances as its population ages. He has also pandered to the religious right, opposing stem-cell research and promoting a federal amendment banning gay marriage.

There are points, to be sure, in Mr Bush's favour. The economy has done reasonably well; the Dow (though not other financial indices) recently hit a record high, inflation is modest and unemployment is at a level that most countries would envy. Despite everything that is going wrong in Iraq, Americans at home have been safe: no terrorist has landed a blow on American soil in the five years since September 11th 2001. Yet these achievements do not play as well for Mr Bush as they should. Growth is slowing, and most of the benefits of the recent boom have accrued to the wealthiest. Economic insecurity is perceived by many to be rising; and polls also suggest that voters increasingly see the Iraq misadventure as threatening their domestic security too. When you see Mr Bush featured in a political television ad, you can be pretty confident that a Democrat put him there.

Collective responsibility

Why should the Republicans in Congress take the blame for Donald Rumsfeld's incompetence or Dick Cheney's tolerance of “waterboarding” terrorist suspects? Because Congress was meant to be the first line of defence. The more an administration errs, the more essential it is that Congress—the first branch of government, according to the constitution—perform its appointed role of supervising the executive with rigour.

In fact the record of the 109th Congress has been terrible. First and foremost, it has failed in its duty of oversight. The conduct of the war, conditions at Guantánamo, the overspending: the administration has seldom had to face hostile questioning from either the House or the Senate. There have been a few honourable exceptions in the upper chamber, notably John McCain's interventions on the use of torture. But in general the Republicans have smothered debate. Omnibus bills, thousands of pages long, have been voted through in the small hours on the nod. The number of days the House spent sitting in 2006 was the lowest in 60 years.

Then there is sleaze. The majority leader of the House, Tom DeLay, had to resign his post because he is facing charges over election-funding violations. Two other sitting Republican congressmen have been found guilty of corruption. The resignation last month of Mark Foley, a Republican congressman accused of sending salacious e-mails to young congressional pages, is merely the latest blow.

Worse than sleaze is pork. All Congresses like to vote money for pet projects, most recently using “earmarks” to tie a grant of federal money to a local scheme. But this one has been astonishing: the number of earmarks has shot up tenfold since the Republicans took the House in 1994. The party of small government has become the party of the absurd $223m “bridge to nowhere” in Alaska. Over the past six years the House Republicans have repeatedly snuffled up the sugar that had been meant to make the bitter pill of entitlement reform go down, without swallowing the hard stuff. Voters might reasonably have expected a degree of austerity from the conjunction of Republicans in the White House, Senate and House. Instead, the past six years have seen a $236 billion surplus transmogrified into a nearly equal and opposite deficit, with the prospect of much bigger deficits to come.

Opposition is true friendship

From the Republicans' viewpoint a spell in opposition could be useful: it would give them a chance to cleanse their Augean stables, temper their fealty to the religious right and get rid of the nonsense of big-government conservatism. The last time they were dumped in a national election, in the Clinton landslide of 1992, they returned with a vengeance in the Gingrich revolution of 1994. A clobbering now would probably make them more likely to turn to an electable candidate in 2008.

For an independent voter the only argument for keeping the Republicans in charge is the prospect of something worse (Cromwell, remember, replaced the Rump Parliament with a military dictatorship). And there are plenty of things to worry about with the Democrats. Their party looks ever more susceptible to the siren call of protectionism. It has no better ideas than the president for dealing with the mess in Iraq (and some worse ones). And robust scrutiny could give way to hotheaded revenge. It would surely do Mr Rumsfeld a power of good to be hauled before opposition-dominated committees from time to time; but talk of impeaching Mr Bush is dangerous. Nancy Pelosi, the worryingly left-leaning representative from San Francisco who is likely to be speaker, will have a tough job keeping control (see article).

Realistically, though, how much damage could a Democratic Congress do? It would be hard for Democrats to force Mr Bush to pull out of Iraq, short of cutting off funds—which no one is contemplating. Their record on spending could hardly be any worse than the Republicans'. On trade, they could do real but limited harm to a few deals in the pipeline, but without the president's approval they cannot force a rethink of NAFTA or alter the terms of trade with China: the Doha round looks sadly doomed whoever wins next week.

In fact it is possible that a divided government could actually work better than a united one. Mr Bush was rather good at bipartisan government when he needed to be, as governor of Texas in the 1990s. And the notion of shared sacrifice can be a powerful one. If both parties are involved in doing difficult but necessary things, neither side can make political capital at the expense of the other and trade-offs can be made. It worked, after a fashion, following the Republican landslide of 1994, with Bill Clinton signing welfare reform. It might work again with immigration reform.

None of this amounts to an enthusiastic endorsement of the incoherent Democrats. There are a few independent-minded Republicans, especially in the Senate, who deserve to keep their seats. But sometimes ruling parties become so addled and incompetent they need to be punished. “Depart, and let us have done with you,” Cromwell told the Rump Parliament. The Republicans deserve the same next week.

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Economics of climate change

Stern warning

Nov 2nd 2006
From The Economist print edition

Sir Nicholas Stern's figures may well turn out to be wrong. That is no excuse for inaction

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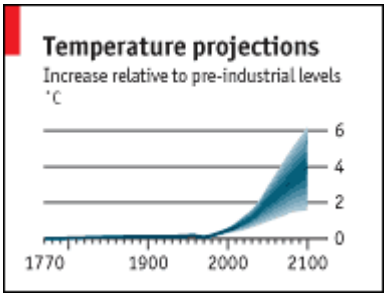

BRITISH civil servants can normally be relied on to favour calm and moderation. Not Sir Nicholas Stern, head of Britain's government economic service. His report on the economics of climate change, published on October 30th, suggests that what he calls “market failure on the greatest scale the world has seen” should lead the planet to panic.

Critics argue with his economics; and there may well be grounds for picking holes in his figures (see article). But that's no reason to ignore his recommendations.

Insuring the world

Gordon Brown, the chancellor of the exchequer, asked Sir Nicholas to look into the economics of climate change because he wanted some solid material to counter the argument of those who accept that global warming is happening but believe mitigating it is too expensive to be worthwhile. That view is rare these days in Europe, but common in America, where it is often infused with the belief that attempts to control greenhouse-gas emissions are part of a European socialist conspiracy to undermine the American way of life.

Sir Nicholas has tried to assess the future costs of climate change—drought in Africa, floods in Europe, hurricanes in America, rising sea levels around the world—and has set them against the costs of cutting fossil-fuel usage enough to stabilise carbon-dioxide concentrations in the atmosphere. His answer to the second part of this calculation is fairly uncontroversial. The costs of switching away from carbon should not be huge because of the rise in fossil-fuel prices and the fall in alternative energy prices. Sir Nicholas reckons that the world could stabilise concentrations at a reasonable level at a cost of 1% of GDP by 2050. Many other economists have looked at the matter, and most agree with Sir Nicholas.

But Sir Nicholas dissents from the general view on the costs of climate change itself. Most economists who have looked at the matter up to now reckon that, if greenhouse-gas emissions continue on their current path, the costs of climate change would be between zero (where the benefits of warming to cold countries balances out the costs) and 3% of global output over the next 100 years. Sir Nicholas thinks they would be a massive 5-20% over the next century or two: in other words, world output could be up to a fifth lower, as a result of climate change, than it otherwise would have been.

He justifies these high numbers on two main grounds. First, he says, the earlier estimates were based on temperature increases of 2-3°C by the end of this century. But the science has moved on. A better understanding of feedback loops in the climate, such as the melting of Arctic ice, which increases the region's tendency to absorb sunlight and therefore reinforces warming, means that, although 2-3°C remains the likeliest increase, scientists now think that warming of 5-6°C is a real possibility. That would be a massive jump: 5°C is the difference between the temperature now and in the last ice age. Second, he points out, most economists have fed only the likeliest climate-change scenario into their models and ignored the outlying possibilities of catastrophe.

Sir Nicholas has received plenty of support from economists (four Nobel prize-winners have endorsed the report) and a certain amount of criticism. One complaint is that he has selected the most pessimistic research and ignored more conservative work. Richard Tol, a professor at Hamburg University and a big

noise in this field, describes the report as “alarmist and incompetent”. Another criticism is that figures on the economic costs of climate change are bound to be nonsense because they are based on a cascade of uncertainties. Nobody knows just how much carbon dioxide the world is going to produce in future. Nobody knows just what it will do to the temperature. Nobody knows just how temperature rises will affect the world economy. These numbers are therefore too uncertain to act on.

Sir Nicholas may well err on the gloomy side. And it is certainly impossible to predict precisely what effect climate change will have had on the world economy in a century's time. But neither point invalidates Sir Nicholas's central perception—that governments should act not on the basis of the likeliest outcome from climate change but on the risk of something really catastrophic (such as the melting of Greenland's ice sheet, which would raise sea levels by six to seven metres). Just as people spend a small slice of their incomes on buying insurance on the off-chance that their house might burn down, and nations use a slice of taxpayers' money to pay for standing armies just in case a rival power might try to invade them, so the world should invest a small proportion of its resources in trying to avert the risk of boiling the planet. The costs are not huge. The dangers are.

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Bangladesh

The hole in the middle

Nov 2nd 2006
From The Economist print edition

Mainstream politicians are doing their best to make extremism attractive

Reuters

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THE map of the Muslim world is littered with states of concern to Western policymakers. Bangladesh is becoming one of the most alarming. Its young democracy has descended into a Punch and Judy show of backbiting and violence between two parties led by women who cannot stand the sight of each other. But this is not a comic sideshow. Their feud is being fought in blood on the streets, in a country of nearly 150m poor people, 90% of them Muslims.

The political system, despite a fragile truce this week (see article) remains at risk of breakdown. The winners in the short term might be ambitious soldiers itching to say “I told you so” about corrupt, incompetent civilians. In the long run the failure of mainstream politics could help the extremist fringe: and Bangladesh's is peopled with Islamists who think the Taliban and al-Qaeda are jolly decent chaps.

The latest bout of violence has been provoked, ironically, by a mechanism devised to take some of the confrontation out of two-party politics: the formation of a “neutral” caretaker government to oversee elections. This time the main opposition, the Awami League, led by Sheikh Hasina Wajed, has cried foul, alleging that both proposed caretakers (first a former chief justice, then the president) are anything but neutral. On the streets her supporters have fought with the police and other backers of the outgoing prime minister, Khaleda Zia, of the Bangladesh Nationalist Party (BNP). Two dozen people have been killed already and hundreds injured.

The president may placate the League. But unless the two sides find a new penchant for compromise, the elections, due in January, will, if they happen, be scarred by violence. Both parties employ thugs. If it all gets too messy, some impatient general might try to restore the military dictatorship that Mrs Zia and Sheikh Hasina helped overthrow in 1990.

Both women are to blame for this mess. Mrs Zia's government has indeed tried to rig the election, or at least, give itself an unfair chance. It has never properly investigated the bombing in 2004 of a rally where Sheikh Hasina nearly died and several of her colleagues did. To retain the loyalty of its Islamist coalition partners, it has connived at the spread of violent extremism. It even denied the existence of some of the groups responsible, until after they had organised the co-ordinated explosion, in the space of

about one hour in August 2005, of nearly 500 small bombs in 63 out of Bangladesh's 64 districts.

Islamists adore a vacuum

But the Awami League has not shown much commitment to democratic politics either. It has scorned parliament and preferred to take to the streets. Its weapon of choice is the general strike, shutting the country down with tiresome regularity. And if there is a light in the present darkness, it is not the League's moderation, but its hopes of electoral victory: the BNP has split, and, however much they try to fix elections, incumbent governments in Bangladesh always lose.

Bangladesh's voters, largely a tolerant bunch with surprisingly astute political judgment, are not easily bullied or hoodwinked. But disillusionment with the main parties leaves a vacuum. Trying to fill it are the Islamists. Some are harmless charitable workers. Some have dangerously illiberal social views. A few are violent jihadists. Bangladesh is still a long way from becoming a hardline Islamic state. But its secular rulers are doing their best to give secularism a bad name.

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The future of Kosovo

Independence days

Nov 2nd 2006
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An independent Kosovo is coming. The question is how best to achieve it

Get article background

THE shabby manoeuvring that triggered first war and then the break-up of Yugoslavia began in Kosovo in 1989, when Slobodan Milosevic scrapped the Serbian province's autonomous status. Now the Balkans have turned full circle, back to negotiations over Kosovo's final status. But this time there is no doubt as to the result: independence from Serbia.

Kosovo is an emotional matter for Serbs. It lay at the heart of their medieval empire, it is where they lost a battle in 1389 that led to 500 years of Ottoman rule and it has some of their main religious sites. It is a Serbian province, not an ex-Yugoslav republic like Macedonia or Montenegro. Yet since NATO's war with Serbia in 1999, Kosovo has been run by the United Nations, not Belgrade. Over 90% of its 2m people are ethnic Albanians who will settle for nothing short of independence.

This remains true despite the recent noisy (if narrow) approval of a new constitution for Serbia reaffirming Kosovo as an integral part of the country. The constitution and the election that will follow, probably in December, are mere delaying tactics by a Serbian government that is not ready to take the blame for “losing Kosovo”. The issue for the UN envoy overseeing the negotiations, Martti Ahtisaari, is whether conditions can be attached to independence to make it more palatable to Serbia (see article).

One such must clearly be the guaranteed protection of all ethnic minorities in Kosovo, especially the 100,000 or so Serbs who remain. That will require local autonomy to be given to municipalities, including Serb ones, which may necessitate redrawing boundaries; and full protection of Serbian religious sites. Another condition may be stopping Kosovo uniting with neighbours (eg, Albania). All this means keeping NATO troops and international observers in Kosovo, even after independence. Other possibilities—partitioning off the Serb-dominated bit of north Kosovo, refusing to let Kosovo join the United Nations—are unlikely to make anyone happier.

Nasty side effects

In short, it seems unlikely that any way can be found of dressing up Kosovo's independence to make it more acceptable to Belgrade. A conditional independence may thus have to be imposed internationally. Russia could block formal approval of this by the UN Security Council, so it may be up to individual countries to choose whether to recognise Kosovo. Most will surely do so, leaving non-recognisers (including Serbia) to follow later. Indeed, some Serbian leaders might welcome such an outcome, since it would show that they had done their utmost to obstruct Kosovo's independence.

Independence without Belgrade's consent may be regrettable, but it is better than denying it altogether, since this would only lead to renewed fighting. Yet it carries two big dangers. The first is of leaving Serbia, the biggest country in the region, in a disgruntled, nationalistic grump. A resentful Serbia may be unable to start another war, but it could still cause trouble across the Balkans. The way to avoid this is for the European Union to lure Serbia back onto the path towards accession negotiations, which it will also be doing for Kosovo. Indeed, it is the EU, not the UN or NATO, that must now play the decisive role. That will take money, but ultimately it also means taking in the western Balkan countries as members.

The second danger is of setting an awkward precedent. Leaders of the (Bosnian Serb) Republika Srpska

already ask why, if Montenegro and Kosovo can be independent, they cannot be. Russia mutters menacingly about Abkhazia and South Ossetia, two enclaves in Georgia, and Transdniestria, in Moldova (though it keeps strangely quiet over Chechnya). But parallels between countries and ethnic groups rarely hold. Few people have been as attacked and oppressed as the Kosovars. Nor should “ethnic cleansing” be rewarded, which it would be in an independent Bosnian Serb republic or Abkhazia. Kosovo's loss of autonomy started the Balkan wars; its independence may, with luck, end them.

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Global retailing

Trouble at till

Nov 2nd 2006
From The Economist print edition

How retailers can avoid foreign adventures ending in disaster

AFP

WHEN Wal-Mart went into Germany in 1997, it assumed that Germans would like to be treated with the same courtesy as Americans. Staff were therefore taught to greet customers by smiling as brightly as they do in any suburb from Pittsburgh to Peoria and to help pack their shopping. That was a mistake. Wal-Mart discovered that many Germans regard shop-assistants who try to help them with suspicion and flee the premises to avoid buying anything from them.

Globalisation often seems unstoppable; but the determined parochialism of shoppers' tastes has turned out to be one of the strongest forces standing in its way. Never mind travel, which familiarises customers with foreign stores; the spread of brands, which means that familiar products like Louis Vuitton handbags, Nike trainers and Starbucks coffee can be bought in almost any country; internet shopping, which makes everything available to everybody everywhere. Wal-Mart sold its German stores to Metro, a local rival, earlier this year. The world's most successful retailers still get into trouble when they expand across borders.

Hardly surprising then that many shopkeepers never leave home. Of the world's top 250 retailers, 104 have no international operations at all, according to Deloitte, a consultancy. The most international big retailer is France's Carrefour. It has stores in just 29 countries, whereas multinationals in other industries might operate in 100 or more countries.

But in rich countries retailing is growing slowly; and in their home markets giants such as Wal-Mart and Tesco are attracting the attention of domestic regulators and the hostility of the public. They need to go abroad to grow. The latest country to interest them is India, where foreign shopkeepers are getting their feet in the door (see article).

Retailers who set out on foreign adventures need to remember three basic rules. First, don't forget the local touch. Wal-Mart got off to a bad start in Germany by appointing a country manager who did not speak German. It also underestimated the local competition: Germany's Aldi and Lidl are champion price cutters. In Brazil it failed to notice that people like to shop *en famille*: the aisles of its shops were too narrow to accommodate the standard family party. Successful foreign adventurers adjust their formats to local needs. B&Q, a British do-it-yourself retailer, discovered that Chinese people look down their noses at doing things themselves. It became a buy-it-yourself, and get somebody else to do it for you, retailer.

Second, make sure your timing is right. In 1995 Yaohan, an aggressive Japanese retailer, opened one of the world's biggest department stores in Shanghai. It planned to build 1,000 Chinese shops. But a decade ago Chinese people were too poor to support its vision and in 1997 Yaohan filed for bankruptcy.

Third, be selective about what you try. Tesco, which has been pretty successful in foreign markets, is shortly going into America—but with convenience stores only, because it reckons the supermarket business is too crowded.

Aisle be back

Bad experiences don't seem to discourage retailers. This year IKEA, which fled Japan 20 years ago, is trying once more to win over the Japanese to the delights of self-assembly. Marks & Spencer, which quit continental Europe in 2001, is planning another overseas push. No big retailer has yet failed in the same overseas market twice. But there's always a first time.

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On America's mid-term elections, Thailand, Nobel prizes, the Panama Canal, talent, Airbus

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Machine politics

SIR – Your observations on the potential problems that could be caused by America's voting machines were mostly on target ("Crash and re-boot", October 14th). Although it is correct that using a paper ballot that can be optically scanned is the best method to achieve openness and reliability, what is also needed is a robust audit programme across every jurisdiction that provides a comprehensive review of the election processes from beginning to end. This would culminate with a statistically valid review of the votes cast.

The current voting system is broken throughout the United States. The problems range from the technical (unreliable electronic touch-screens with insecure software, confusion in a plethora of local systems) to the partisan (questionable purges of registered voters, party control of election operations). Americans' faith in their system is in danger of breaking down, further depressing the already poor record of voter turnout. We have a right to vote by secret ballot, but the casting and counting of those votes needs to be more transparent.

Cheryl Lilienstein
Palo Alto, California

SIR – The map accompanying your article on ballot initiatives labelled those states that ban gay marriage as being "states where opposite-sex marriage is protected in the constitution" ("Questions, questions", October 14th). Denying gays the right to marry does not "protect" heterosexual marriage. Massachusetts, the only state to legalise gay marriage, has one of the lowest divorce rates in America. Southern states, where gay marriage is widely prohibited by constitutional amendment, have some of the highest.

Tory Sullivan
Miami

SIR – All sitting Republicans and Democrats deserve the electorate's scorn for their years of disingenuous service. As I told a sincere-looking canvasser recently, the candidate who can say "I am not the incumbent" will get my vote.

William Oberbeck
Wauwatosa, Wisconsin

Participative democracy

SIR – It is right to emphasise the crucial role that political parties will play in guiding Thailand back along the path to genuine democracy ("Returning to democracy", October 7th). During the past six years the parties were systematically undermined through illegal and unconstitutional means. In an environment where civil liberties were curtailed, the free media were suppressed, alternative views were denied a public airing, parliament was frustrated, and independent agencies designed to provide checks and balances were interfered with, parties became diminished and the "ruling clique" became stronger.

The subsequent corruption and abuse of power that is only now being revealed confirms most of the

allegations raised by the opposition during that period. The fact that all the former opposition parties are still intact, while Thaksin Shinawatra's Thai Rak Thai party is disintegrating, is also proof that given an open debate and fair play, political parties will not only survive but also reinvigorate democracy in Thailand.

Surin Pitsuwan
Deputy leader
Democrat Party
Bangkok

An economic winner

SIR – You noted with respect to Muhammad Yunus and the Grameen Bank having won the Nobel peace prize that “the only surprise is that it was so long in coming” (Face value, October 21st). You then pondered if lending to the poor as practised by Grameen “has led to peace” and that this is the big “unanswered question”. Perhaps the Nobel peace prize selection committee took so long because they thought someone ought to make the award given the economics committee hadn't done so. It would be nice if the Nobel economics prize occasionally went to a practitioner instead of only theorists who impress other theorists.

Richard Norgaard
Professor of energy and resources
University of California
Berkeley

Cutting a swathe

SIR – The canard that the original Panama Canal construction project came in under budget is just that: a canard (“The voters and the ships”, October 21st). I conducted research with Carlos Yu that looked at the construction expenditures of the Isthmian Canal Commission and compared them with the initial cost-estimates presented to Congress. The Panama Canal, in fact, ran over budget by a factor of 2.1, well above the overruns incurred in building similarly sized projects like the Hoover Dam or the Bay Area Rapid Transit system. The canal also opened to commerce seven years later than scheduled. Of course, past performance does not predict future results, and the Panama Canal expansion project may indeed come in on time and under budget. But that is not the best way to place a bet.

Noel Maurer
Assistant professor
Harvard Business School
Boston

HR speak

SIR – Timo Hannay seems puzzled that “attracting and retaining talent” is not the number one priority for 25% of human-resources managers and thinks they should be sacked (Letters, October 28th). I'll take a wild stab in the dark and suggest that the priority of these managers may be to increase company profits. If I were in charge, I would rather sack those who chase the latest buzzword. Remembering what a company is actually paying you for while being bombarded on all sides by blue-sky nonsense; that is talent worth retaining.

Samuel Blanning
Bath

Plane talking

SIR – I read with interest your article about the problems at Airbus (“In place of Streiff”, October 14th). The statement in your rubric that “Louis Gallois takes over as boss of Airbus, but the dollar problem remains” is no doubt correct (given there “has been a 30% drop of the dollar against the euro in recent years”), but this identifies the effect not the cause. Although I cannot profess to know the details surrounding the debacle at Airbus, I think I can safely say that the root cause of its woes is “process”, not a differential between costs and sales. The problems at Airbus are analogous to assigning two crews to build a bridge where each starts construction on the opposite banks of a river and, as the bridge

comes together at mid-span, they discover that the two sides do not match.

Noel Nightingale
Executive director
Lean Aerospace Initiative
Massachusetts Institute of Technology
Cambridge, Massachusetts

SIR – You said that the Boeing 747 was also delayed, for two years in 1969 ("The airliner that fell to earth", October 7th). The letter of intent, signed in December 1965, proposed the first delivery in November 1969. Actual first delivery, signed by me for Pan Am, was December 12th 1969. That is a date I cannot forget. It was my wife's birthday and I was late for dinner.

Robert Wallace Blake
Pan Am, retired
Seattle

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America's mid-term elections

Goodbye to the permanent majority?

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From The Economist print edition

Two years after George Bush's triumphant re-election, the Republicans are stumbling to a pummelling by a lacklustre Democratic Party. Here's why

LAST month, George Bush was interviewed on ABC television. The presenter told him that no fewer than 72 Democratic candidates for the House of Representatives “are putting you in their campaign ads”. The president asked: “Are they saying good things?”

It was vintage Dubya: charming, disarming and *faux naif*. Of course the Democrats all hate me, he seemed to imply; what can you expect when I stand so firmly by my principles? That is not, however, why Mr Bush's party is poised for a whipping on November 7th.

For five of the past six years Republicans have held all the levers of power in Washington—the presidency and both arms of Congress. (A defector cost them control of the Senate in 2001, but they won it back the next year.) For better or worse, Republicans must take responsibility for what the federal government has achieved during this period. And despite a buoyant economy, low unemployment and no significant terrorist attacks on American soil since September 11th 2001, most Americans think little has been done.

The president's approval rating is below 40%. Congress's is under 30%. Two-fifths of voters say they are “angry” with the administration: twice the proportion who said so in 1994, when the Republicans rode a wave of disgust with Democratic incompetence to capture both houses of Congress.

Virtually every political crystal-ball-gazer reckons the Republicans will lose their majority in the House of Representatives next week. Some predict they will lose the Senate, too. For a party whose cockier strategists have boasted of a “permanent Republican majority”, this is quite a come-down. How did it happen?

The Republicans' unpopularity is inextricably linked with that of Mr Bush. Voters who loathe him would obviously prefer a Democratic Congress to curb him. But more significantly, in electoral terms, many of those who voted for him in 2004 now wonder if unified Republican government is such a good thing. If these wavering Republicans either switch sides or stay at home on polling day, the party they once backed will get a thrashing.

There are many reasons why they have become disillusioned by Mr Bush's party, but two stand out.

When the Republicans have stuck by their principles, they have done so incompetently. And in too many areas that matter to their natural supporters, such as fiscal prudence, they have not stuck by their principles at all. Add to this toxic cocktail repeated shots of scandal, from Abu Ghraib to Mark Foley, a Republican congressman who exchanged salacious e-mails with adolescent pages online, and the wonder is that their ratings are not even lower.

Iraq is the prime example of a principled policy, poorly executed. It is also the issue that will hurt the Republicans most at the polls, because they have steadily lost the confidence of those who, at first, supported the invasion.

This was a gradual process. Although no stockpiles of chemical weapons were found in Iraq, many Americans knew that Saddam Hussein had used them before, and believed he would have built them up again had sanctions been lifted. To many, replacing an odious tyranny with something resembling a democracy seemed a good enough reason for ousting him.

The last time Americans went to the polls, in 2004, 52% of them still thought that invading Iraq had been the right thing to do. Now only 40% do, and only one in five thinks America is winning the struggle there. Some doubtless assume this is because Iraqis are incapable of democratic self-government, but many blame bungling by their own side.

Better-informed American voters ask why Mr Bush's representatives in Iraq let looters gut Baghdad, why they sacked the civil servants who knew how to operate the electricity grid, and why they disbanded the army. The less well informed have a less detailed—but no less definite—impression of failure. They probably have not heard that the first name proposed for a reconstituted Iraqi army, the New Iraqi Corps, when abbreviated to NIC, means “fuck” in Arabic. But they do know that, three and a half years after apparent boasts of victory, there are still a lot of American troops in Iraq, and the place looks an utter mess on the evening news.

All washed up

In January last year a majority of Americans started telling pollsters that invading Iraq had been a mistake. Nine months later the Republicans' reputation for competence took a further lashing, when Hurricanes Katrina and Rita hit the Gulf Coast.

Much of the bile heaped on Mr Bush over Katrina was unfair. First, the disaster was not as ghastly as the media painted it. The stories of chaos, murder, rape and even cannibalism among the storm's victims turned out to be false. Second, much of the blame for the wretched response to the hurricane belonged to Democrats: Louisiana's dithering governor, Kathleen Blanco, and the mayor of New Orleans, Ray Nagin, who let school buses that could have been used to evacuate people sit idle until they were half-submerged.

In the end, though, Mr Bush made the response to Katrina a federal responsibility, and the federal government botched it. The rescue effort was ill co-ordinated. Billions of relief dollars were wasted. The Department of Homeland Security's inspector-general noted, for example, that $900m was splurged on 26,000 mobile homes for evacuees, when regulations forbid the use of such homes on flood plains, so 11,000 of them were left “sinking in the mud” in Arkansas.

The Katrina clean-up could cost $200 billion. And that is perhaps the most troubling lesson from the debacle: that Bush Republicans will throw money at a problem if they think it will make them popular. Ryan Sager, the author of “The Elephant in the Room: Evangelicals, Libertarians and the Battle to Control the Republican Party”, describes it like this:

> As Bush's poll numbers [sank] in the New Orleans floodwaters, he sent his staff scrambling to spend money at a pace that might dispel the notion, expressed most memorably by rapper Kanye West...that “George Bush doesn't care about black people.” He pre-emptively waved off the concerns of fiscal conservatives, saying that rebuilding was going to “cost whatever it costs”. [When some small-government Republicans] began pushing for budget cuts to pay for the Katrina clean-up, then majority leader Tom DeLay declared that there was simply no fat left in government to cut: “Yes, after 11 years of Republican majority we've pared it down pretty good.”

Mr Delay's boast was so ridiculous that it brought what Mr Sager calls “a sudden moment of clarity”. This

was less than two months after the passage of the lardiest highway bill of all time, including a $223m bridge connecting the Alaskan town of Ketchikan to an island with a population of 50. If that was what the number-two Republican in the House of Representatives called “pared down pretty good”, it was clear that the Republican revolution of 1994 was over.

Twelve years ago, Newt Gingrich and his Republican footsoldiers swept to control of Congress by promising to slash federal spending. For a while, they kept that promise. Between 1995 and 2000, with a Republican Congress acting as a check on a Democratic president (and vice versa), real federal spending per head remained nearly frozen. When Mr Bush took office, however, Republican lawmakers were reluctant to restrain their own man. In Mr Bush's first five years real per head federal spending grew by 3.1% annually, making him the most fritter-happy president since Lyndon Johnson (see table). Under Mr Clinton, the number of federal employees shrank by 200,000 (excluding the armed forces and postal service). Under Mr Bush, it rose by 79,000.

Divide and save

Annual growth in federal spending per head under recent administrations

Unified government*	Growth, %
Lyndon Johnson	4.6
George Bush junior	3.1†
Jimmy Carter	2.9

Divided government	Growth, %
Richard Nixon/Gerald Ford	1.9
Ronald Reagan	1.7
George Bush senior	0.6
Bill Clinton	0.3

*President's party controlled House and Senate during most of term †First five years

Source: "Buck Wild: How Republicans Broke the Bank and Became the Party of Big Government", by Stephen Slivinski

William Niskanen, a former economic adviser to Ronald Reagan, speculates that divided government itself may be the key to fiscal restraint. Using data going back to Harry Truman's time, he found that real annual growth per head in federal spending averaged 1% under divided government and five times that under unified government.

With no hostile Congress to block him, Mr Bush has been free to follow his political instincts. There was once some ambiguity about what these were. When he first ran for president, he said he believed in limited government, and boasted that if his race with Al Gore were a spending contest, “I would come in second.” But he also distanced himself from Republicans in Congress by accusing them of “balanc[ing] their budget on the backs of the poor.”

Once in office, he appointed a budget director with a reputation for frugality, Mitch Daniels, who even tried—unsuccessfully—to make the phones at the Office of Management and Budget play the Rolling Stones' “You Can't Always Get What You Want” to callers on hold. But Mr Bush never gave Mr Daniels the latitude to make real cuts, because he was determined that everyone should get what he had promised them during his campaign.

Spending galore

The biggest handout was a prescription-drug entitlement for the elderly, known as Medicare Part D, which passed by a handful of votes in 2003. It addressed a real problem: some 22% of the elderly lacked drug coverage. But it did so in the costliest way imaginable. It is not means-tested, so old people who previously paid for their own drug coverage have an incentive to mooch off the taxpayer instead. It will cost an estimated $1.2 trillion over the first ten years—making it the biggest expansion of the welfare state since Mr Bush was dancing the Alligator at Yale.

The Bush Republicans passed the bill to woo the 40m elderly Americans, a group that seldom forgets to vote. Some were doubtless grateful, but since the plan started working this year, many have complained that it is confusing (which it is) and stingy (because it covers the first $2,250 of drug spending and anything over $5,100, but leaves a “doughnut hole” in the middle). Democrats, meanwhile, argue that the plan is too generous to drug companies. Voters seem to agree.

Some conservatives take comfort in the fact that a potentially significant conservative reform—the creation of individual health savings accounts—was attached to the Medicare drug bill. But even they fret that $1.2 trillion is a lot of money to win not a great many votes.

The other big reform of Mr Bush's first term, the No Child Left Behind Act, was supposed to jolt the American public out of their longstanding preference for Democratic education policies. The idea was to get Congress to swallow serious conservative reforms by sugaring them with federal cash. In the end, schools got extra cash without the key reforms.

The first draft created a voucher programme, so that kids in awful schools could take their share of federal funds to better ones, public or private. But Democrats and left-leaning Republicans on the relevant House committee replaced this bold reform with a vague guarantee that children in “failing” schools could transfer to non-failing ones. The catch was that state education officials were able to dumb down the tests so that schools which ought to have earned a “failing” grade did not do so. They also made it so tricky to transfer from a rotten school that in 2004-05 only 1% of eligible children did so.

The theory of big-government conservatism has few defenders. Mr Bush himself shuns the label. Fred Barnes, the journalist who coined it, argues that Mr Bush “is a visionary”, and that his philosophy of using the immense power of government for conservative ends is “the conservatism of the future”. Others see it as the triumph of expediency over principle. When Congress passed a grotesque package of farm subsidies in 2002 and Mr Bush signed it, many Republicans were convinced that it was the lesser of two evils. If they failed to support uneconomic farms, they figured, they might lose crucial Midwestern votes and hand power back to the Democrats. The same logic allowed Mr Bush to impose tariffs on imported steel that year. He knew that protectionism makes people poorer; but given the number of steel mills in swing states, he thought he'd better protect them anyway.

Economic glow, economic gloom

Ugly compromise is the essence of politics. But the Bush Republicans have backed down so often on the domestic front that some of their erstwhile supporters wonder what they stand for, apart from winning elections.

Consider what was supposed to be the headline reform of Mr Bush's second term, an overhaul of Social Security (public pensions). Arguing, correctly, that the system is heading for bankruptcy as the country ages, Mr Bush spent much of early 2005 promoting the idea that Americans should be allowed to shift some of the money they currently drop into the common retirement pot into private accounts, to invest as they please. The public was at first ambivalent; but the more the president campaigned, the less popular the idea became, until the Republicans ran for cover, and reform died.

Big-government conservatism has another serious flaw: it fosters corruption. The more cash the government sprays out, the greater the temptation to bribe those who aim the firehose. The most prominent scandals have involved actual criminal behaviour. Randy “Duke” Cunningham, a Republican congressman, was caught trousering bribes from defence contractors to pay for his gaudily furnished yacht; Jack Abramoff, a well-connected Republican lobbyist, was convicted of fraud.

More troubling, however, is the much larger number of lawmakers—nearly all of them, in fact—with perfectly legal conflicts of interest. A congressman has the power to “earmark” funds for a specific project. He can insert the earmark into a big, fat, unrelated bill, in the hope that it passes without anyone reading it. And he can accept campaign donations from the beneficiaries of his largesse, so long as no favour is explicitly traded. According to Citizens Against Government Waste, a watchdog group, the number of porky earmarks has exploded under Republican rule, from 1,439 in 1995 to 13,997 last year. Congress's response to recent bribery scandals has been to impose footling restrictions on lobbyists. But the only effective way to curb corruption would be to trim the pork.

By some measures, the economy has been doing quite well under the Republicans. Productivity growth has been strong, unemployment is low and inflation modest. Although output growth is slowing as the housing market slumps, petrol prices have plunged in the past couple of months and the stock market is up.

Yet Americans are gloomy. Three-fifths of them tell pollsters that economic conditions in the country are getting worse, a much higher share than in 2004. Economists argue ferociously about how close this is to being true. The more dismal-minded ones point to average hourly wages, which rose by a slothful 0.6% annually between 2000 and 2006 once you adjust for inflation. Sunnier ones point out that if you include benefits, total hourly compensation rose by 1.3% a year over the same period. Yes, say the pessimists, but that is eaten up by soaring health-care costs. All right, say the optimists, let's look at consumption per head, which rose 17% in total between 2001 and the second quarter of 2006. Ah, say the doomsters, but that is because consumers are recklessly over-borrowing. No, say the optimists, it is because the Bush tax cuts left more money in their pockets.

Both sides make some valid points. But on balance the naysayers have the upper hand. The Bush economy has not felt great for most workers, for three reasons. First, workers' compensation—at least until recently—has been surprisingly sluggish, while firms' profits are at a record high. Americans have kept up spending by borrowing, largely against the value of their houses. Their savings rate is now negative. Second, the gains of growth have been skewed to the highest earners. Rising income inequality means that average income can be growing smartly, even as most workers are not much better off. Third, as Jacob Hacker of Yale University points out, incomes are much more volatile than they were a generation ago. People may be better off, on average, but they worry more about losing their jobs, and with it their health insurance and their ability to pay their children's college fees. None of this helps the Republicans; polls show that Americans prefer the Democrats on every economic issue bar taxes.

Bush about to be beaten

The Republicans' most reliable remaining supporters are religious conservatives and those who applaud Mr Bush's tough line on terrorism. The former cannot imagine ever voting for the Democrats; but some may stay at home on polling day. Mr Bush impresses them with his religiosity and his picks for the Supreme Court, but some feel that his “faith-based” social programmes are more about symbolism than ending poverty. And religious conservatives are repelled by the Foley scandal.

As for the terror hawks, many are doubtless appalled at the idea of a Democratic Congress hamstringing a wartime commander-in-chief with investigations. But some think Mr Bush would have been a better president with a hostile legislature to keep him on his toes.

One should never underestimate the Democrats' flair for losing. But if they cannot capture at least the House of Representatives on November 7th, argues George Will, a conservative columnist, “they should go into another line of work.”

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The mid-terms

Time to launch the ground war

Nov 2nd 2006 | LOGANSPORT, INDIANA
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AP

Both parties' footsoldiers are preparing to go over the top

“HELLO! Great to see you again!” Joe Donnelly, the Democratic candidate for Indiana's second district, has never set eyes on your correspondent before. But when your eyes are bleary with exhaustion, one face looks much like another. Mr Donnelly has spent months pumping hands, wolfing soggy dinners with gusto and begging strangers to let him serve them in the House of Representatives. Now, at a fundraiser at a small-town golf club, he is preparing to recycle his stump speech once again.

The polls give him an edge over Chris Chocola, the Republican incumbent. But he cannot afford to rest easy between now and November 7th. Iraq, he tells the $40-a-plate audience, has been a disaster. China trades unfairly. Republicans give oil companies billions in tax breaks while failing to fund pre-school programmes here in Cass County, Indiana. And so on. He gets a standing ovation. “He's a very good candidate,” says Mike Meagher, who sits on the local hospital board. “He would represent the man in the street.”

The Democrats need a net gain of 15 seats out of 435 to recapture the House, and six, out of 33 contested, to take the Senate. Since most incumbents are safe, because of gerrymandering and the greater ease with which they can raise money, the result will depend on a couple of dozen hard-fought races. Most voters will have made up their minds by now, so both parties' priority is to enthuse their supporters to get out and vote.

Most campaign spending goes on the air war—the dogfight of political ads on television and radio. This is now reaching a peak of intensity. In the final week of the campaign even casual television viewers in the metropolitan Washington area, for example, can expect to see 42 ads relating to the toss-up Senate race in Virginia, according to the *Washington Post*. Viewers in Tennessee can watch actors sarcastically endorsing the Democratic Senate candidate with lines such as: “Harold Ford looks nice—isn't that enough?” and “So he took money from porn movie producers. I mean, who hasn't?” The Democrats, meanwhile, have enlisted the actor Michael J. Fox, who suffers from Parkinson's disease, to film ads lashing Republicans for obstructing stem-cell research.

But even more important is the ground war—the hard slog of knocking on doors, posting fliers, making phone calls and trying to get voters to the polls. Indiana is one of the key battleground states, with three

House races out of nine looking competitive. Both parties have descended on the state to rouse their infantry.

The Democrats' greatest advantage is that most people are fed up with the Republicans. The Republicans' edge is that a substantial minority think the Democrats are what Ramesh Ponnuru, a conservative zealot and author, calls “the party of death”, favouring “unrestricted abortion, lethal research on human embryos, and euthanasia.” And Christian conservatives make faithful ground troops.

Consider Brittney Ranft, a 17-year-old volunteer for Mr Chocola. She says she would like to be a missionary when she is older, perhaps in Bolivia. In the meantime she is happy to work the phones for a man she believes is a good Christian. She calls people the campaign has identified as Republican or leaning that way, and reminds them to vote. She has made 2,000 calls so far. How did she get so much time off classes? “I home-school,” she says.

The conventional wisdom is that the Republicans have a superior “get-out-the-vote” operation. Certainly, that was true at the presidential election in 2004. This year, it is hard to say, because both parties are so secretive. Grover Norquist, an anti-tax campaigner close to Karl Rove, the Republicans' chief strategist, says Republicans are contacting even more voters than they did two years ago, though he concedes that the Democrats might also have upped their game, as they indeed claim.

Some say the Republicans' critical advantage in 2004 was that they were better at “micro-targeting”—using a sophisticated database to identify which voters might respond to which messages. Most famously, they targeted snowmobile owners in Michigan with warnings that the Democrats favoured environmental rules that would impede their frozen frolics. This year, the Democrats are furiously trying to catch up. Few observers think they have done so.

Alexander Gage, who heads TargetPoint Consulting, a firm that helps the Republicans “know their voters”, says his services can be worth 10,000 votes in a close congressional race. If you know that a voter in Ohio is male, over 35, votes in primaries, drives a sport-utility vehicle and reads *Golf Digest*, there is a 90% chance he is a Republican, he says. His firm collects such information from public records and consumer database companies, and packages it so that Republicans can pinpoint potential supporters and woo them to the polls. He adds that Republicans are better at this because they centralise and share information, whereas various Democratic interest groups tend to fight over who controls it. Democrats counter that they are getting better at sharing, partly through the co-ordination of an umbrella group called America Votes.

Don Green, a professor of political science at Yale, thinks micro-targeting is over-hyped. The idea that which car or magazine you buy predicts how you will vote has captured the imagination of the chattering classes, he says, but the best guide is whether you vote in a party primary. Consumer data are expensive and can at most predict a quarter of the variance in voting preferences, he reckons.

He has also conducted experiments to see which tactics work best in the ground war. There is a mountain of evidence, he says, that more personal forms of contact are better. Meeting a voter face to face makes him seven percentage points more likely to vote for you, he claims. Getting a chatty volunteer to call him earns you three. Sending a taped message down the phone appears to have no effect at all. And phone calls are only a third as effective if the caller is a hired mouth rather than a true believer. That helped the Republicans in 2004, when they recruited more true believers. This time, who knows?

Direct mail can spur people to vote, if they already agree with its message. Democratic pollsters have found that voters get more mail from Republicans, the same number of phone calls, and slightly more door knocks from Democrats.

Pressure groups pitch in, too. The Family Research Council, a conservative Christian group, has sent out 200,000 congressional report cards. (The pro-life Mr Chocola scores 100%.) And MoveOn.org, a pro-Democrat group, has sent an e-mail to its 3.3m members purporting to be from Dick Cheney, ordering them not to attend a MoveOn phone bank party—or “I'll take you quail hunting.”

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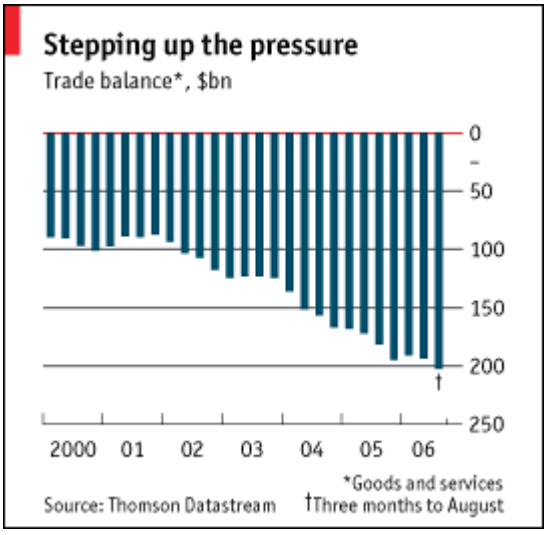
Trade policy

Slow track

Nov 2nd 2006 | WASHINGTON, DC
From The Economist print edition

A more Democratic Congress would not help the cause of free trade



WITH George Bush still in the White House, it is easy to exaggerate the economic consequences of a Democratic victory on November 7th. For all the talk of rescinding the Bush tax cuts and doing more to help the middle class, Mr Bush's veto pen will limit how much the Democrats could do even if they were to take over both chambers of Congress.

The stalemate of divided government might well lead to better policy, particularly on the budget. But in one area Democratic control of one, let alone both, parts of the legislature would mark a clear change for the worse. Mr Bush's trade agenda would be stalled. And as the economy slows, the White House might then find it harder to hold off protectionist pressure from Capitol Hill.

The most obvious casualty would be “trade promotion authority” (TPA, or “fast track”), the negotiating licence that the White House uses to conclude trade deals. Mr Bush narrowly won this authority from Congress in the aftermath of the September 11th terrorist attacks. It runs out in June 2007. Although Charles Rangel, the top Democrat on trade policy in the House of Representatives, has not ruled out extending a revised form of TPA if he is in charge, few on Capitol Hill believe him. Democrats would be in no mood to give Mr Bush any political victories, and TPA extension would be a juicy prize.

For the same reason several bilateral trade deals would look less likely. The Bush team has signed free trade agreements with Peru and Colombia. It is negotiating with others, including South Korea and Malaysia. All would have trouble passing a Congress with more Democrats in it. (To avoid this fate, the White House might try to push the Peru deal through the lame-duck Congress later this month.)

It is tempting to conclude that none of this matters very much. After all, the Doha round of trade talks—for which TPA is needed—lies comatose after five years of fruitless negotiations. The bilateral deals, with the exception of South Korea, are small. With so little at stake, so what if the trade agenda is stalled?

The reason to worry is that Democrats' aversion to trade deals goes beyond thumbing their noses at Mr Bush. Lawmakers in both parties have become more sceptical about trade, but the Democrats are clearly the more protectionist party. A generation ago both the House and Senate contained large bipartisan groups of free-traders. In the House of Representatives, that coalition has long since fallen apart as the ranks of free-trade Democrats have dwindled. Democratic success in the Senate on November 7th may push the chamber in the same direction.

The most vulnerable Republican senators are free-traders. Their challengers range from rabid protectionists to moderate trade sceptics. At one extreme is Sherrod Brown, a congressman from Ohio's rustbelt and one of the most militant foes of free trade on Capitol Hill. He has written an entire book denouncing trade (“Myths of Free Trade”) and wants to renegotiate all America's big trade deals, especially NAFTA. Bob Casey, the Democratic challenger for a Senate seat in Pennsylvania, “opposes any trade law that sends American jobs overseas”. Jim Webb, the Democratic challenger in Virginia, wants to impose tariffs on countries that refuse to bring their labour and environmental standards into line with America's.

Some of this may be campaign bluster. The Senate has always had trade sceptics, but some of today's challengers seem of a different hue. As Doug Irwin of Dartmouth College points out, they are not industry-based protectionists—people who want support for specific products, such as textiles or steel. Rather, they sound dubious about free trade on all fronts. Worse, that scepticism is rising in the party's upper ranks. Although Max Baucus, the Democrats' top man on trade in the Senate, is a moderate liberaliser, neither the party's Senate leaders nor those in the House are champions of freer trade.

That bodes ill for new trade deals and increases the risk of backsliding. In the past few years there has been lots of protectionist rhetoric, but little action. Charles Schumer and Lindsey Graham, two senators who shouted loudly for huge tariffs if China did not revalue its currency, recently withdrew their bill. But if the economy slows and the number of congressional Democrats rises, it may get harder for Mr Bush to stick up for free trade.

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Absentee ballots

Often voting early

Nov 2nd 2006 | WASHINGTON, DC
From The Economist print edition

Why election day no longer means what it did

AS NOVEMBER 7th draws ever closer, the parties are spending a fortune and the airwaves are glutted with ads. But in some races it is too late. A handful of folk are still undecided, but millions have already voted.

In 2000 14% of the vote was cast early, either in person at polling stations or by absentee ballot, through the mail. By 2004 the figure had swelled to 22%. “Election day” is becoming a quaint nickname for an ordinary Tuesday. “There are many election days, beginning in September,” writes John Fortier of the American Enterprise Institute.

As recently as 1980 almost everyone voted on the same day. New York, Pennsylvania and more than a dozen other states stick to tradition: no early voting, and you need a good excuse to get an absentee ballot. At the other end of the spectrum is Oregon. The state adopted a postal-vote system in 1998. All registered voters get absentee ballots automatically, and there are no polling stations at all.

The other states take a middle path. Texas issues few absentee ballots, but nearly half its voters hit the polls early: polling stations throughout the state are open for two weeks before the nominal election day. By election day two-thirds of voters in Washington state will have already sent in their ballots. Some states open their polling-station doors a whole month early.

Advocates say that early voting is convenient and encourages turnout. But the trend has made life more complicated for some. Pity the political strategists. “If you're going to release a last-minute scurrilous charge, you have to do it earlier,” says Paul Gronke of Oregon's Reed College. As to whether it boosts participation, opinion is divided. In most states people have to go out of their way to request an absentee ballot. “Those people would have voted anyway,” says Curtis Gans of American University. If anything, he argues, “convenience voting”, as it is often called, depresses turnout by diffusing efforts to mobilise voters.

Election experts worry that absentee and early voting can be dangerous. People who vote before election day know less than those who wait. That is not necessarily a bad thing. George Allen, the Republican junior senator from Virginia, is spending the last few days of his campaign pointing out the dirty bits in his challenger's novels. Still, early voters “might actually miss more substantive parts of the campaign,” says Mr Fortier. In Tennessee polls opened before the candidates met for their last debate. At least early voting “has the protection of the polling place”, as Mr Fortier puts it. Absentee voting is much more open to fraud.

The trend in voting early will probably continue. Many Americans have become understandably reluctant to take their chances on election day. After technical glitches made a hash of Maryland's primary election in September, Governor Bob Ehrlich called for state voters to request absentee ballots.

Whether or not early voting affects the results, it is changing the way Americans think about elections. Mr Fortier thinks that extended voting detracts from the public benefits of a single election day. Mr Gronke, going further, would like to make election day a national holiday. “Voting is a civic ritual,” he says. “We need to make it more important, not less.”

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New York

Mr Fixit's biggest test

Nov 2nd 2006 | NEW YORK
From The Economist print edition

One place where the election is not in any doubt

THE elections may be a time of high drama across America, but not in New York. Not only is Hillary Clinton a shoo-in for re-election to the Senate, but Eliot Spitzer, the state attorney-general, is leading his hapless Republican opponent, John Faso, by a gaping margin—at the last count, 71% to 22%. Mr Spitzer's challenge is not to win the governor's office; the challenge lies in what he must do once he gets there. As attorney-general he relentlessly tackled Wall Street's corporate malefactors. But that was a trifle compared with the fight that awaits him in Albany.

New York's finances are a mess. Debt per person is more than twice the national average, and the state faces budget gaps of almost $7 billion over the next two years. Mr Spitzer's first test will come quickly, as he must propose a budget by February 1st. Over the long term he must fix New York's biggest fiscal problem, its bloated Medicaid programme. It is America's costliest by far: New York spends $45 billion on Medicaid, 30% more than California, which has almost twice as many people. Mr Spitzer has ambitious plans to cut costs, from rooting out fraud to closing hospitals. But these changes will not come easily. A Wall Street billionaire was a much easier target than a nurse in Buffalo will be.

The new governor must also improve the state's failing schools. New York spends more on its students than any state except New Jersey, but has the third-lowest graduation rate in America. On top of the usual fights over reform, such as making it easier to set up independent “charter” schools, the new governor must settle a 13-year lawsuit that demands the state pump more cash into New York City's schools. Mr Spitzer promises to resolve the matter quickly, yet squabbling seems inevitable. He favours a solution that sends money to schools across the state and has suggested the city chip in as well—a proposal that has already raised the hackles of Michael Bloomberg, the city's mayor.

Then there is the dire problem of how to help upstate New York, which is poor and shrinking. Lawmakers have tried to revive the region by pouring cash into projects in so-called Empire Zones—an approach Mr Spitzer says has become “distorted by the political process”. The area's economy will not improve until its business climate does. Mr Spitzer has proposed a mild property-tax cut and promised reforms to lower workers'-compensation costs, reduce electricity costs (now 63% above the national average) and streamline regulations.

Unfortunately, any reform will face the perennial log-jam in Albany. New York has become an example of state politics at its worst. In a damning new book, “Three Men in a Room”, a former state senator, Seymour Lachman, describes how power is entrenched in the hands of the governor, the Senate majority leader (usually a Republican) and the Assembly speaker (usually a Democrat). These men often give their underlings just a few hours to review bills the size of phonebooks; lawmakers then vote as they are told, for fear of being denied aid for their districts.

The capital is a playground for special interests, with more lobbyists per legislator (18 to one) than any other state. Public authorities, appointed bodies that pay for projects by issuing state bonds, are to blame for most of New York's debt. No one even knows how many authorities exist, though there are said to be “at least 733” of them. Thanks to gerrymandering, an inept legislator, once he has been elected, is usually there for life.

Fixing this requires a bold leader. Mr Spitzer has audacity to spare. But as attorney-general he could act almost unilaterally. As governor he will have to compromise. The Spitzer campaign's favoured slogan is “Day one, everything changes”. That is impossible. But he may nudge New York in the right direction.

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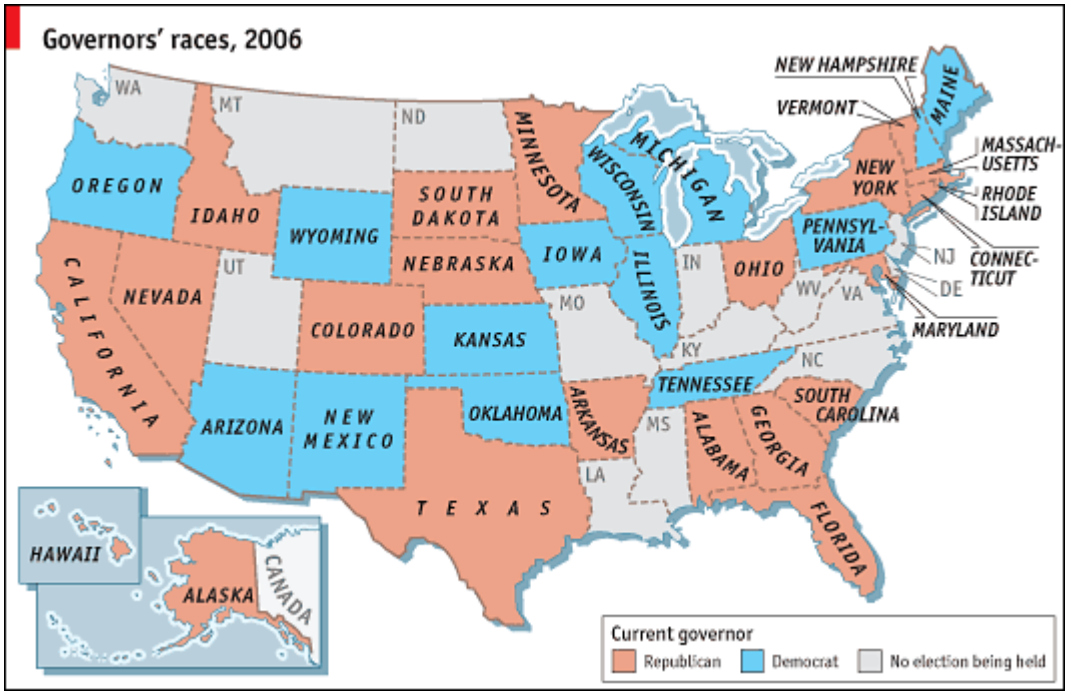
State elections

Thinking local

Nov 2nd 2006 | CHICAGO
From The Economist print edition

The battle for mansions and statehouses



THE House and Senate are not the only prizes up for grabs next Tuesday. With 36 races for governor and several finely balanced state legislatures, the parties are also slugging it out over control of the states. A wave of anti-Republican voting would help Democrats in a number of closely divided statehouses; and although 28 of America's governors are Republicans, the party is bound to take some losses as it tries to defend 22 of those spots at the polls this year.

Some states are so evenly matched that a slight break either way could give one party total control. In Iowa, for example, the state Senate is split down the middle, the Republicans hold the slimmest of leads in the lower house (50-49), and the governor's mansion is being vacated by Tom Vilsack, a Democrat who declined to run for a third term. Chet Culver, another Democrat, is very slightly ahead. His opponent, Jim Nussle, has spent the past 16 years in Washington, DC as a Republican member of Congress—an unpopular occupation these days.

Iowa is one of the few states where Democrats are on the defensive. Another is Michigan, where battered domestic car firms and a flailing local economy have driven the jobless rate above 7%, the second-highest in the country. The incumbent, Jennifer Granholm—one of the Democratic Party's stars after she won the job four years ago—has tried to pin the blame on George Bush and the national economic climate. Her opponent, Dick DeVos, a businessman, counters that she has failed to diversify the state's economy, and backs lower business taxes and simpler regulations as a way to speed the process.

The Republicans meanwhile are bracing for some bruising losses and would be happy just to limit the damage. One problem is that nine of the governor spots they must defend are open races this year, in most cases because of term limits. The party is looking shaky in many of those. In both New York state and Ohio, for example, where George Pataki and Bob Taft are leaving their mansions, the Democrats look likely to take over. Even in arch-conservative Idaho the Democrat, Jerry Brady, is giving Butch Otter, a Republican congressman, a run for his money in an open governor's race.

Three other open races are in states where Democrats already control both legislative chambers: Arkansas, Colorado and Massachusetts. If they can hang on to those majorities, and replace the outgoing Republican governors with their own—all three races are leaning towards the Democrats—they will add total control of at least three more states to the eight that they already run outright. (The Republicans run 13, counting conservative but nominally non-partisan Nebraska.) One of the few bright spots for Republicans is Arnold Schwarzenegger's rebound in California. His approval ratings plunged last year, but after humbling himself and blowing Democrats a few kisses the Gubernator seems to be running away with it.

Besides shifting the power balance within several states, these races will also affect national politics in the future. If Democrats can hang on to whatever they win for a while, they will have a better chance to reshape district lines after the next census, in 2010. Moreover, governors' mansions and statehouses act as training grounds for national office. Four of America's past five presidents were governors before entering the White House. And even if none of this year's winners becomes president popular or respected governors tend to boost their party's national image. They often sound much more responsible than the partisan hacks in Washington, DC.

State legislatures are also one of the main talent pools from which the parties fish for future congressional candidates. More than half of current House members started out this way. And it is easier for state legislators to make a name for themselves if they are in the majority. Republicans currently control both chambers in 20 states (plus unicameral Nebraska), and Democrats in 19, with the other ten split. But since many of the majorities are narrow, both parties are pouring money into state legislative races. The Democratic Legislative Campaign Committee has spent nearly $10m; its Republican counterpart twice that. Tuesday will tell how sound their investment was.

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Senator Kerry steps in

There he goes again

Nov 2nd 2006 | WASHINGTON, DC
From The Economist print edition

Cometh the hour, cometh the gaffe

AP

The secret weapon

THE Republicans have spent the past month praying for a miracle. Last week they thought that it might come in the form of a ruling on gay marriage by the New Jersey Supreme Court. But the court produced a frustratingly nuanced judgment—strengthening the rights of same-sex couples but refusing to mandate the use of the term “marriage”.

Now they think that they may have better luck with a foot-in-the-mouth comment by Senator John Kerry. On October 30th Mr Kerry extolled the virtues of education to a group of students at Pasadena City College, in California. Make the most of education, Mr Kerry said, otherwise “you get stuck in Iraq”.

To which the Republicans replied: thank you God. George Bush—obviously relishing the chance to relive the glories of 2004—slammed the comments as “insulting” and “shameful”. America's troops are “plenty smart” and “plenty brave”. John McCain told his fellow Vietnam veteran that he owed the troops an apology.

Mr Kerry is the gift that keeps giving—to the Republicans. His gaffe provided them with a chance to change the subject from the troubles in Iraq to the presumed troubles of the Democrats—such as elitism and a lack of patriotism. And it gave them a chance to put John Kerry's face back on the Democratic Party.

The Democrats have tried to make the election about Mr Bush and his botched war in Iraq: the party plans to run Iraq-focused ads in at least 15 of the most competitive House races in the run-up to election day. The Republicans will now try to respond by making the election about “John Kerry Democrats” and their belief that people only serve their country because they are too dumb to get into law school.

Mr Kerry responded by digging himself deeper into his hole. The comment, he said, was a “botched joke”. Apparently he did not mean that if you fail to study you will end up in the army; rather, if you fail to study you will end up leading an ill-thought-out war in Iraq. That must have come as useful advice to any members of his audience who were contemplating a career as commander-in-chief.

The chances that Mr Kerry's October gaffe will continue to resonate until next Tuesday are slim. Mr Kerry is not on the ballot. He has issued an official apology. And the images of his exercises in self-justification will soon be replaced on television screens by images of mayhem in Iraq. But the gaffe has nevertheless consumed valuable oxygen just a week before the election—and has given a needed jolt to the Republican machine.

The biggest loser from the gaffe will be Mr Kerry himself. Several leading Democrats, such as Harold Ford, a Senate candidate in Tennessee, quickly denounced his comments. Others cancelled campaign appearances with him. In private the party brass were spitting tacks—wondering whether Mr Kerry was not content with just losing one election for his party. The number of people who share Mr Kerry's belief that he should run for the presidency again in 2008 has always been small. It has just got a lot smaller.

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Hell houses

Wooooooooooo

Nov 2nd 2006 | WASHINGTON, DC
From The Economist print edition

Welcome to hell. Admission: $8.00

Get article background

A SKELETON or a zombie might kill you. But going to a rave could imperil your eternal life. Secular haunted houses are incompetent to address these dangers. Besides, they celebrate a pagan holiday. So this October, hundreds of churches around America hosted their own horror shows, to rival Halloween.

In “hell houses”, sometimes known as “judgment” or “reality houses”, young actors depict the consequences of drinking, partying or being gay. Women who are casual about sex might reconsider once they see how it leads to a bloody late-term abortion, for example.

Reuters

Another raver pays the price

The idea is credited to the Rev Jerry Falwell, who first staged a hell house in 1972. Liberty University, the college he founded in Lynchburg, Virginia, produces a sophisticated annual event called Scaremare. This year's theme was “The DaScaremi Code.” Thousands waited in line for hours to attend. A few teenagers whiled away the time by discussing the metaphysics of the Trinity.

Scaremare was, as its promotional material promised, “a balance between a fun house and a house of death.” But it was not really a hell house. Apart from a crucifixion tableau, there was no overtly Christian message until the end, when visitors were herded into a tent. Inside, a student gave a rambling but heartfelt lecture on original sin, escape via death, the evangelical mission and the emptiness he felt before being saved.

Most churches that bother to put on a haunted house are not interested in such a soft sell. And a small congregation does not need vast resources to scare people. Colorado's New Destiny Christian Centre sells “Hell House Outreach Kits” for a modest fee. The kit includes scripts for scenes such as the funeral of a young man “who believed the born-gay lie and died of AIDS”. Supplemental sound effects, such as “Splinter the Family Unit” by Lucifer Voice, are also available if needed.

Hell houses have fans outside the evangelical community. An event in Oklahoma was “seriously lots of fun”, wrote one student in a review for his college paper. “Too bad I had a Jesus hangover in the morning.” The phenomenon has even reached the east coast. Last month an experimental theatre company in New York staged its own “Hell House” off-Broadway. It was well received. But the real hell houses are controversial. Mainstream Christians think that evangelism and scare tactics are mutually exclusive. Some hardliners, in contrast, object that no one should have to pay to hear the Gospel.

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Lexington

Madam Speaker?

Nov 2nd 2006
From The Economist print edition

Nancy Pelosi is poised to become the first female speaker of the House of Representatives

NANCY PELOSI is one of those politicians who seems made for caricature. She is the very embodiment of privileged liberalism—the wife of a rich-as-Croesus property investor and the representative of a city, San Francisco, that, as far as most Americans are concerned, is synonymous with ageing hippies, lay-about trustfunders, aggressive beggars and gay parades.

Ms Pelosi's public appearances do her no favours. Often she talks drivel. “The gavel of the speaker of the House is in the hands of special interests”, she said recently, “and now it will be in the hands of America's children.” Her speeches consist of a mixture of robotic talking-points (the Republicans are guilty of “the politics of corruption”) and clumsy alliteration (the Democrats are a “great collection of idealism, intellect and integrity”). It's like listening to a cross between a Stepford wife and Jesse Jackson. Yet Ms Pelosi has been at the top of the Democratic Party's greasy pole for almost four years. And, if the polls are right, she is poised to become the first Democratic speaker of the House in twelve years. This will not only make her the first female speaker; it will make her second in line for the presidency after Dick Cheney.

What can be made of all this? Is Ms Pelosi's rise a symptom of the dysfunctional state of the Democratic Party? Or is there more to the San Francisco liberal than meets the eye? America will have to wait until next Wednesday for an answer. If her party fails to take the House, she will be remembered only for missing an open goal; if they succeed, she will be an instant hero, at least on the left, a feminist pioneer who simultaneously broke the glass ceiling and gave George Bush a bloody nose.

Contrary to Lexington's expectations, Ms Pelosi has put in a creditable performance as opposition leader. She has raised more money than any other congressional Democrat—around $100m since taking over the job—and forced colleagues in safe seats to spend their time raising money for those in close races. She has also imposed a remarkable degree of unity on her party.

The Democrats are about as easy to control as Afghan warlords—headstrong and addicted to bloody feuds (the past few months have seen open warfare between Rahm Emanuel, who runs the House campaign committee, and Howard Dean, the party chairman). But Ms Pelosi has done pretty well. The *Congressional Quarterly* calculates that House Democrats voted with the majority of their party 88% of the time in 2005, the highest total since *CQ* started keeping track in 1956.

This is testimony to Ms Pelosi's toughness. The lady from San Francisco learned the art of politics in the old school. Her father, a New Deal congressman turned mayor of Baltimore, kept a ledger of favours done and owed, and “Little” Nancy, the youngest of six children and the only girl, was in charge of the book. She has had no compunction about dishing out favours to her underlings—and about threatening punishment for miscreants.

Her party's unity is also testimony to her grasp of Groucho Marx's great principle, as laid down in “Horse Feathers”: “Whatever it is, I'm against it.” Ms Pelosi realised that she did not need to compete with the White House in producing bright ideas that the Republicans might steal. Nor did she need to try to trump Mr Bush's Social Security reforms with reforms of her own, which might lead to a Bush-boosting compromise. All she needed to do was to oppose the White House.

This strategy has been triply successful. It deprived the White House of a victory on Social Security, one that could have provided momentum for the rest of the second term. It kept the Democratic caucus from fragmenting. And it forced the Republicans to resort to all sorts of dubious methods to get controversial legislation past a near-united opposition, from keeping votes open for hours to stuffing the pockets of doubting colleagues.

Checking, not overreaching

A victory next Tuesday will increase Ms Pelosi's ability to make life difficult for Mr Bush, not just in blocking his initiatives but in investigating his past deeds. But it will also confront her with a new set of problems. Speaker Pelosi will arouse the expectations of a liberal base that is hog-wrestling-mad at the president. She will also bring with her 19 powerful committee chairmen who are itching for the limelight after 12 years in the dark. Her problem will be less with the Republicans than with her own side.

But Ms Pelosi's style may be exactly what is needed in such circumstances. She is much more interested in running the party machine than in driving a far-reaching agenda. And she has laid the groundwork for her speakership well. She has drawn up a legislative programme that appeals to Middle America—from raising the minimum wage to extending stem-cell research. She has used Congressman John Murtha, a close confidant and leading war critic, to lay down the law to her party. Changes in Iraq policy must be made “in conjunction with the White House”, he says, and impeachment is off the table.

This is unexciting stuff. It is a far cry from the days when Newt Gingrich turned Congress into a combination of political theatre and policy laboratory. But Congress, lacking the presidential bullhorn, is a much less effective policymaking instrument than the White House, as Mr Gingrich eventually discovered. And Ms Pelosi's cohorts in Congress hardly represent the future of her party. Seven of the 19 prospective Democratic chairmen will be over 70 when the 110th Congress convenes. Thirteen voted against welfare reform. New ideas are best left to the party's presidential candidates, who can fashion them into a coherent shape and test them in the long race for the White House.

If Ms Pelosi understands that division of labour, as it seems that she does, and if she concentrates on checking the president without overreaching, she has a reasonable future as America's first female speaker. A pity she's so bad on television.

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Correction: Maine's water wars

Nov 2nd 2006
From The Economist print edition

Last week, an early-morning gremlin made our calculator divide rather than multiply in two conversions ("Source of trouble", October 28th). The right figures are 416m litres and 122cm. Sorry. The relevant article has been corrected online.

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Nicaragua

Who's afraid of Daniel Ortega?

Nov 2nd 2006 | MANAGUA
From The Economist print edition

An election with much historical baggage and a familiar front-runner attracts more outside meddling than it deserves

Reuters

Get article background

ALMOST everywhere in Nicaragua in recent weeks someone can be heard playing or crooning a bowdlerised version of “Give Peace a Chance”. Daniel Ortega, who was president in the 1980s following the Sandinista revolution, has made John Lennon's hymn into his latest presidential campaign's theme song.

Mr Ortega became president last time after the Sandinistas overthrew the dictatorship of Anastasio Somoza; they went on to become bitter enemies of the United States. He lost the presidency to Violeta Chamorro in 1990. This will be his third attempt since then to win his old job back. But in this general election, due on November 5th, his chances look better. That is in part because his opponents are divided. But it is also because he has been able to engineer a change in his image—and a change in the electoral rules.

In the 1980s, when Ronald Reagan was president, the United States cared so much about Nicaragua that it organised a guerrilla war by *contra* rebels against the Sandinistas. It earned some of the money it sent to the *contras* by selling arms to revolutionary Iran. In some parts of the Bush administration, Mr Ortega still inspires fear and loathing. Though he no longer talks like a Marxist, he is a friend of Cuba's Communists and of Venezuela's anti-American Hugo Chávez.

Yet he appears nowadays to value power above ideology. His Sandinista Front is a personal fief from which he has expelled those who challenge his leadership. And he is indiscriminate in his choice of allies. Mr Ortega's vice-presidential candidate is a former *contra* leader. He has also made an informal pact with Arnoldo Alemán, a reactionary former president convicted of corruption, against the current president, Enrique Bolaños.

Between them, Mr Ortega and Mr Alemán used their control of the legislature to change the electoral rules. To avoid a run-off ballot, the winning candidate had previously to secure 45% of the vote. That hurdle has been cut to 40%, or 35% with a five-point lead. This boosts Mr Ortega's chances. Opinion polls, though unreliable, give him around 35%, about twice as much as each of the two candidates who

hail from the (conservative) Liberal party. José Rizo is the official Liberal candidate, loyal to Mr Alemán; Eduardo Montealegre is Mr Bolaños's finance minister.

All three would have faced a strong challenge from Herty Lewites, a popular former mayor of Managua who led a reformist group of former Sandinistas. But Mr Lewites died of a heart attack in July. He has been replaced by Edmundo Jarquín, a former official at the Inter-American Development Bank.

Mr Ortega would almost certainly lose a run-off election. Much is thus at stake on Sunday. The electoral authority is packed with partisans of Messrs Ortega and Rizo. But the election will be closely watched by hundreds of observers from the Organisation of American States (OAS), the Carter Center and the European Union. The chances of fraud are “minimal”, says Jaime Aparicio of the Carter Center.

Nicaragua has a population of just 5.5m. Even so, outsiders have queued up to meddle in the election. America's ambassador and its secretary of commerce, Carlos Gutierrez, have both said that a victory for Mr Ortega would be bad for Nicaragua and made clear their preference for Mr Montealegre. That prompted a scolding from the OAS. Undeterred, Oliver North, the Reagan administration's chief *contra* warrior, dropped in for a few hours to campaign for Mr Rizo. Mr Ortega, for his part, has the active backing of Venezuela's Mr Chávez, who has given subsidised fuel and fertiliser to Sandinista mayors.

Travel the pot-holed roads of Nicaragua's backlands, and it would be easy to believe that this is indeed a polarising election. Lorries and school buses full of demonstrators clatter past, heading for one rally or another. The main pitch of Mr Montealegre, an upper-class former investment banker, is that he alone can beat Mr Ortega and so prevent a return to the “misery, death and pain” of the 1980s. Mr Rizo's message is similar.

Still, the United States and Mr Ortega have both changed since he was last in power. He no longer opposes the Central American Free-Trade Agreement with the United States. And the United States has meddled less than in the past, says Rodolfo Delgado of the Institute of Nicaraguan Studies, a non-partisan think-tank in Managua. Mr Jarquín says the country would face hard times if Mr Ortega won “not because of what he would do, but because of the fear he generates.” Because of that fear, the election is still anybody's to win.

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Brazil's presidential election

Lula's second chance

Nov 2nd 2006 | BRASÍLIA
From The Economist print edition

A remarkable political comeback and a need for a clear political compass

AP

ONLY around 4,000 people turned up on São Paulo's Avenida Paulista to celebrate the re-election of Brazil's president, Luiz Inácio Lula da Silva, on October 29th. That was a mere fragment of the vast throng that gathered in the same place four years ago. But for Lula, victory was almost as sweet. After a surprising failure to win outright four weeks earlier he thrashed Geraldo Alckmin, his centre-right opponent, in the run-off ballot by 61% to 39% of the valid votes and with 5.5m more votes than in 2002. His scandal-plagued Workers' Party (PT) won five of Brazil's 27 state governorships, its biggest haul. It had already secured the second-largest number of seats in Congress's lower house. “The victory is Brazil's,” proclaimed the re-elected president's T-shirt.

That remains to be seen. The government began by sowing confusion about its intentions. Tarso Genro, Lula's top political manager, declared that “the Palocci era has ended,” a dismissive reference to Antonio Palocci, the finance minister who in Lula's first term backed austere fiscal and monetary policies to bring down inflation and stabilise the economy. Unnerved, investors sold Brazil's currency and bonds. Reports that the government would place the central bank under the authority of Mr Palocci's less austere successor (rather than of the president) and renegotiate the debts of the states contributed to the unease.

Lula offered quick reassurance. “[W]e will continue with a responsible fiscal policy [and] inflation targets,” he insisted. He finds it easier to say what he will not do (unleash inflation) than what he will. His main promise is to lift economic growth from its average of 2.7% in his first term to at least 5% starting next year. But how?

The government accepts the idea that lower public spending can lead to lower taxes and interest rates, boosting growth, but hopes this can be done painlessly. With growth at 5%, current spending will fall as a share of GDP, says Mr Genro. But few economists expect growth of more than 4% next year. Looking further ahead, a faster pace requires reforms to reduce the cost of pensions and employment. These “need to happen”, says Mr Genro, but low- and middle-income Brazilians “can't be hurt”. Another priority is to simplify Brazil's tangle of separate value-added tax systems for each of the 27 states, ending the “fiscal war” in which states lure investors by cutting rates.

“No reform will be dealt with seriously without political reform,” says Mr Genro, meaning changes to the way Congress is elected and the imposition of party discipline. In Lula's first term, his government mishandled a legislature composed largely of politically footloose mercenaries, which provoked corruption and legislative paralysis. Political reform is on “everyone's wish list, but if you ask which model there's no consensus,” says José Eduardo Cardozo, a PT congressman. Even if such a consensus is reached, changes are likely to apply only in the future.

According to Sérgio Abranches, a political analyst, the greater obstacle to economic reforms is the lack of detailed proposals from the executive rather than the lack of congressional will to enact them. A governing coalition that spans half-a-dozen parties from the centre-right to the left will have a hard time producing them.

Even so, Lula looks stronger politically than looked possible a year ago, when scandal was mowing down

his closest aides and his popularity. The PT lost seats in the prosperous south and south-east of the country, but gained some in the poorer north-east. The party's incoming congressional contingent looks less left-wing than the current lot. They “will cause many fewer problems for the government,” says Jairo Nicolau, a political scientist at IUPERJ, a research institute.

The largest member of the coalition, the fractious Party of the Brazilian Democratic Movement (PMDB), may be more reliable after the weakening of its anti-government wing in the elections. “Practically all the PMDB will go into government,” predicts Mr Nicolau. Two-thirds of the 27 state governors are friendly to Lula. The president's main problem will be in the Senate, which is evenly divided between government supporters and opponents.

Lula intends to reduce the PT's weight in government (it controls 19 of 34 ministries). Before, ministries were distributed to regional leaders on the basis of their political clout. Now, says Mr Genro, “we will negotiate with the parties as institutions” and give ministers more responsibility. Lula himself plans to play a larger role in managing the coalition and relations with Congress.

In victory, Lula has been conciliatory, saying that the “true adversaries” are backwardness and social injustice. He will get a friendlier response from opposition governors than from congressional foes, who will continue digging into corruption allegations against the PT. Lula is entitled to enjoy what is a remarkable triumph. To make it Brazil's triumph too he must decide what to do with it.

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Bolivia

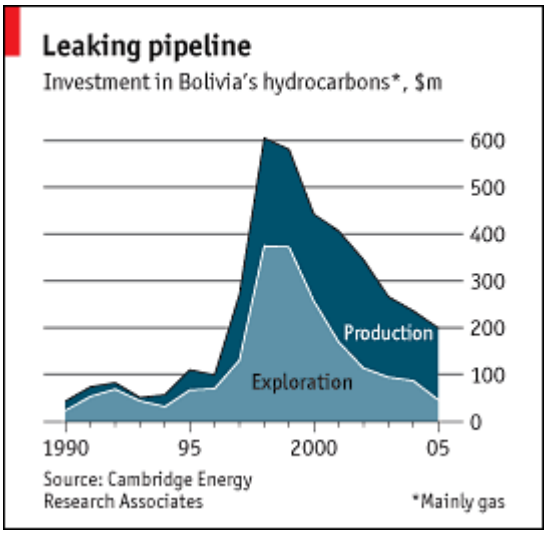
A hard bargain

Nov 2nd 2006 | LA PAZ AND SÃO PAULO
From The Economist print edition

Evo Morales deals and wins on gas

WHEN Evo Morales, Bolivia's socialist president, announced the "nationalisation" of his country's oil and gas on May 1st, he gave the foreign companies that had invested $3.5 billion in the industry six months to accept new contracts. These would turn them into heavily taxed providers of services to Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), the revived state energy company. Just minutes before the deadline, late on October 28th, ten energy companies signed up to new terms that Mr Morales said will raise the government's energy revenues to $1 billion this year and four times as much by 2010.

That is a big political victory for the president. But several important details have yet to be decided. And it is not clear whether the new terms will reverse the precipitate fall in investment (see chart), and thus enable Bolivia to develop its reserves of natural gas, which are the second-biggest in South America.



The nationalisation began with a bang in May, when Mr Morales led troops in occupying a gasfield operated by Petrobras, Brazil's state-owned energy company. But the government was slow to draw up new contracts. In September the president fired his energy minister after Brazil objected to his plan to expropriate refineries owned by Petrobras. He had earlier sacked the head of YPFB too.

The new terms are less draconian for the companies than the May 1st nationalisation decree, but much harsher than their original contracts. Petrobras, the biggest operator, with almost half of the gas reserves, will now pay royalties and taxes of 50% on its two biggest fields, down from 82% under the decree. After Petrobras defrays its costs (including amortisation) it will split the remaining revenue with YPFB under a variable formula.

Broadly speaking, that is in line with a 2005 law approved under the government of Carlos Mesa. Mr Morales had judged this law so weak that he led the street protests that overthrew Mr Mesa. Other companies, including Spain's Repsol, Total of France and BG of Britain have signed similar new contracts. In some mature fields the tax take will total 80%.

The new contracts give YPFB majority ownership of the industry. But the companies will be rather more than mere service providers. "We're not losing ownership," insists José Sérgio Gabrielli, Petrobras's chief executive. His company will be "partners" with YPFB, which will have the right to "supervise" decisions on suppliers, he says. How that will work in practice is unclear. Talks are continuing over Petrobras's demand for compensation for its two Bolivian refineries, which are supposed to be turned over to YPFB. Also still under negotiation is an increase in the price Brazil pays for Bolivian gas from the present $4.20 per million BTUs.

Petrobras has largely amortised its investment in the gasfields and has "very good cash flow" from them, says Mr Gabrielli. He adds that the contracts guarantee Petrobras a rate of return on capital of over 15% and that the company can continue to book Bolivian gas reserves.

Juan Carlos Ortiz, the president of YPFB, said the companies have promised new investment totalling some $3.5 billion. But Petrobras insists it has made no new commitments and has no plans to expand in

Bolivia. Brazil had no choice but to negotiate because it relies on Bolivia for half its gas. But earlier plans to double the capacity of the gas pipeline from Bolivia have been suspended. Petrobras is investing to boost gas production at home.

Mr Morales's hopes of increasing gas exports lie with Argentina. Its president, Néstor Kirchner, last month signed a deal under which imports of Bolivian gas would quadruple to match those of Brazil, at an initial price of $5 per million BTUs. This requires a new pipeline, costing $1.2 billion, as well as investment in developing new gasfields.

A triumphant Mr Morales hailed the new contracts as a big step towards solving Bolivia's social problems. He has wisely struck a bargain with the companies, albeit one that is so hard as to risk being counter-productive. In similarly pragmatic vein, this week he said he was postponing previously announced plans to nationalise Bolivia's mining industry, because he lacked the necessary funds. Having secured extra revenues from gas, his task now will be to spend them wisely.

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Mexico

The feds and the governor

Nov 2nd 2006 | OAXACA
From The Economist print edition

An insurrection may be inching towards a close

AP

EACH night this week hundreds of federal riot police have slept in the central square of Oaxaca, a colonial city of 250,000 people in southern Mexico. On October 29th, in a military-style operation, some 4,000 police, clubs banging on riot shields and backed by tear-gas, water cannon and helicopters, inched their way through barricades of burning buses and crowds of chanting protesters. The protesters, who have brought much of the city to a halt for five months, said three people were killed in the operation.

Mexico's president, Vicente Fox, had come under mounting pressure to intervene to settle the conflict in Oaxaca, which began with a teachers' strike and grew into a quasi-insurrection aimed at ousting Ulises Ruiz, the unpopular governor of the state. The police operation was readied weeks ago, but stayed by Mr Fox's fear that it might turn into a bloodbath. His hand was forced when three people, one of them an American activist, were shot dead on October 27th, apparently by plain-clothes local police.

Mr Ruiz is an old-style political boss from the Institutional Revolutionary Party (PRI), which continues to rule Oaxaca much as it ruled Mexico for seven decades until Mr Fox's victory in 2000. His opponents say he owed his election to fraud, and that he diverted state funds to his party's presidential campaign.

This week he returned to his offices in the city for the first time in months. The teachers have agreed to go back to work. But Oaxaca, once a tourist magnet, is not yet at peace. The protesters' leaders have retreated to the university. Their followers have set up camp outside the monastery of Santo Domingo, an architectural jewel. By night many streets are barricaded; by day they are blocked by marches.

Mr Ruiz now rules only by courtesy of the federal government: were the police to leave the city, he would have to as well. His days look numbered. In what looked like a quid pro quo for Mr Fox's police operation, the PRI's national leaders backed a resolution approved by Mexico's Congress calling on the governor to “consider his position”.

If Mr Ruiz does resign, the PRI would almost certainly lose the resulting election. On December 1st Felipe Calderón takes over from Mr Fox as Mexico's president. He needs the support of the PRI to pass a budget and economic reforms. The battle of wills in Oaxaca may be drawing to a close, but it is not over yet.

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Bangladesh

Campaign of violence

Nov 2nd 2006 | DHAKA
From The Economist print edition

Reuters

As the two big parties slug it out, democracy may lose the elections

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RARELY in the rudest of health, Bangladesh's democratic institutions are looking in worse shape than ever. The five-year term of a coalition between the Bangladesh Nationalist Party (BNP) and its Islamist allies expired on October 27th. A dysfunctional parliament was dissolved and a partisan president, Iajuddin Ahmed, has had himself sworn in as head of an unelected interim government, to oversee elections due in January. But it is still far from certain that the more than 90m voters will actually be given the chance to choose a new government.

Mr Ahmed, previously only titular head of state, is now the president of the republic, home, defence and foreign ministers, commander-in-chief of the armed forces and his own adviser. This apparently unconstitutional concentration of power, combined with Mr Ahmed's poor health, is a recipe for instability. No legal challenge will pass the country's highly politicised judiciary. And the election commission, supposed to ensure free and fair elections, is full of appointees with cringe-making records of partiality.

In Dhaka these days the most common piece of equipment on the desks of politicians, academics and journalists is a copy of the country's constitution. But it may prove irrelevant. The country endured long periods of military dictatorship after independence from Pakistan in 1971.

Another coup seemed likely by October 29th. By then some two dozen people had already been killed, some in deliberate assassinations, and hundreds injured in clashes between the BNP and supporters of the Awami League, the main opposition. The League objected to the man who under the constitution should have led the interim government, a retired chief justice with past BNP links, K.M. Hasan. After the protests, he refused the job.

The outgoing administration, led by Khaleda Zia, the prime minister, had reportedly drafted declarations for the deployment of the army and the promulgation of a state of emergency. But the army is split along party lines and anxious not to sully its reputation (it makes a lucrative contribution to United Nations

peacekeeping operations). So it refused to intervene, and on the evening of October 29th the president was sworn in as “chief adviser” in the presence of Mrs Zia, military dignitaries and foreign diplomats. The League boycotted the oath-taking ceremony, provoking fears of continued violence.

Alarmed at the possibility of a military takeover, however, the League called off its protests. For once, pragmatism won. Sheikh Hasina lost 16 family members, including her father, Sheikh Mujibur Rahman, a former prime minister, in a military coup in 1975. Moreover, the violence was damaging the opposition's standing, and, since its electoral chances remain bright, the League is keen to go to the polls. Since the restoration of democracy in 1991, anti-incumbency has been the rule in Bangladeshi election results.

But the truce may be short-lived. The League has given the president a deadline of November 3rd to “prove his neutrality”. It wants a reconstituted election commission, a revised voter list and a thorough purge of the civil service and police. On November 1st the League did not raise objections to the president's choice of “advisers”, who will run the interim administration until the elections. It was further appeased by a shuffle of senior civil servants, and the sacking of the chief of the country's controversial and trigger-happy paramilitary force. But the League fears that unless the election commissioners are replaced by neutrals the BNP may yet manage to rig the elections.

One thing that will boost the League's chances is that the BNP has split. A new political force, the Liberal Democratic Party (LDP), led by Badruddozza Chowdhury, a former president, and Oli Ahmed, a senior BNP leader, is campaigning on an anti-corruption platform. Hossain Zillur Rahman, a Dhaka-based political commentator, argues that the new party is unlikely to challenge the dominance of the two big mainstream parties. But he says the LDP will be an important voice in Bangladeshi politics.

The LDP says it wants to create a new kind of politics. But it is also in part the product of a personal vendetta by its founders against the BNP, and especially the young leaders surrounding Mrs Zia's son, Tarique Rahman. In the popular mind, this clique is seen as comprising the real power in the land in recent years, and one reason why Bangladesh scores so badly in global corruption rankings. The stakes for the LDP are high. At least four BNP defectors to the new party have seen their houses burned down in a campaign of intimidation.

Bangladesh's polluted mainstream politics has left the country's institutions weak and made fair elections difficult. The system of caretaker governments was introduced in 1996, to safeguard democracy from the winner-takes-all instincts of the two big parties. Now, however, that very system has become part of the threat.

Most foreign concern about Bangladesh in recent years has focused on the spread of violent Islamic extremism, on the fringes of what is still a largely tolerant and moderate Muslim country. The fear recent events inspire is of a breakdown of the fragile secular political order, leading to a messy deadlock or military intervention, and a field-day for the radicals.

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Pakistan's tribal areas

Tales out of school

Nov 2nd 2006 | KHAR, PESHAWAR
From The Economist print edition

Another controversial attack on “terrorists”

Get article background

PERVEZ MUSHARRAF, Pakistan's president, naturally prefers not to bomb his own citizens. But earlier this week helicopter gunships under his command attacked a seminary in the country's mountainous tribal belt. A salvo of missiles killed at least 80 people in a *madrassa* near the town of Khar in the Bajaur tribal agency, bordering Afghanistan. According to the army, they were “miscreants” cooped up in a “terrorist training facility”.

This was the highest death toll for a single operation against suspected Islamist militants in Pakistan. In response, angry protests were mounted by thousands of local tribesmen along with Islamist political groups in Khar, as well as in Peshawar, the capital of North-West Frontier Province (NWFP), and other cities across Pakistan. On the eve of the attack the government and Bajaur's tribal leaders were poised to strike a peace deal. Local reports claimed that some of the dead militants had been party to peace talks only days before. Why the need for the “massacre”?

Local tribesmen said those killed were in fact innocent young students. But General Musharraf dismissed the notion. The tribal agency is indeed believed to be a refuge for al-Qaeda and other forces fighting in the neighbouring Afghan province of Kunar. Among the dead was the *madrassa's* leading cleric, Liaquat Hussain, reportedly a deputy of al-Qaeda's number two, Ayman al-Zawahiri. He was also a local leader of Tehrik-e-Nifaz-e-Shariat-e-Muhammadi (TNSM), a banned group that sent 8,000 men to fight American-led forces in Afghanistan in 2001.

The attack coincided with a trip to Pakistan by Britain's Prince Charles. In the past Pakistan has been accused of launching headline-grabbing attacks whenever Western dignitaries drop by. But what irked Pakistanis most was that the action appeared to have been done at America's bidding. Pakistan's armed forces claimed that their gunships fired “three or four” missiles into the *madrassa*. But locals talked of seeing American unmanned Predator aircraft, armed with Hellfire missiles. Both Pakistan and America's army denied that drones fired on the *madrassa*, but Pakistan did let slip that American intelligence had been used to conduct the operation. In this and previous attacks in the tribal areas locals claimed that American missiles struck the target first and then Pakistani forces followed up.

Most worrying for the civil administration that tries to run the tribal areas, the destruction of the *madrassa* may have jeopardised the Bajaur peace deal. Two months ago a controversial agreement was signed in another tribal agency, North Waziristan, where the Pakistan army had become bogged down fighting pro-Taliban militants. Something similar seems on the cards in Bajaur, where the government had already released six TNSM prisoners. Some American commanders doubt the value of the North Waziristan deal and claim that attacks on their troops have greatly increased since it was signed on September 5th. American officials have also, more discreetly, criticised a vaguely comparable deal struck by British commanders with tribal leaders in the Musa Qala district in Afghanistan.

Ali Muhammad Jan Orakzai, a retired general who is the governor of NWFP and negotiated the Waziristan deal, was said to be “stunned” by the *madrassa* attack. However, the politics of this war is a cut-throat business. Both the government and the mullahs of Bajaur have already indicated that the deal is still on.

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North Korea's bomb

Talking again

Nov 2nd 2006 | BEIJING
From The Economist print edition

Six-party talks are to resume. Two cheers

AMERICA'S chief negotiator on North Korea, Christopher Hill, has not “broken out the cigars and champagne quite yet”. But on October 31st just three weeks after conducting its first nuclear test, North Korea agreed to resume talks on dismantling its nuclear-weapons programme. The Americans say there are no conditions attached.

The breakthrough came at a secretly arranged meeting in Beijing between Mr Hill and his North Korean and Chinese counterparts. Mr Hill expects the six-party talks on North Korea's nuclear projects (also involving Japan, Russia and South Korea) to resume this month or maybe in December.

Remarkably, by Mr Hill's account, the North Koreans are no longer insisting that America first end its campaign against what it says is North Korean counterfeiting. The six-party talks began in 2003 but North Korea withdrew last year, because, it said, of America's blacklisting of a bank in Macau, Banco Delta Asia, accused of abetting North Korea in scams such as distributing counterfeit dollars and smuggling cigarettes. The blacklisting led the bank to freeze some $24m-worth of North Korean funds, and to similar measures by other banks. Mr Hill has agreed to set up a “mechanism” within the six-party talks to discuss this issue.

The North Koreans are also not insisting that, before talks, the United Nations drop the sanctions it imposed after the nuclear test, or the milder ones adopted after missile tests in July. North Korea had described the latest sanctions, banning the sale of nuclear technology, large-scale military equipment and luxury goods, as a “declaration of war”.

One reason for North Korea's apparent change of heart may be that UN officials are still finalising a list of items to be covered by the sanctions. Losing access to imported luxury goods could upset North Korea's leader, Kim Jong Il. He is rumoured to use them extensively to buy support from senior officials as well as to pamper himself. A spokesman for America's State Department said these sanctions would remain in force. But after North Korea's announcement, South Korea said it might resume food and fertiliser aid, which it had suspended in response to the nuclear test. Japanese officials have been more diffident about the agreement and insist their country's sanctions remain in place.

George Bush said he was “very pleased” with the “progress being made”, and praised the role played by China. But it is unclear whether Beijing, whose lack of clout over its neighbour was exposed by the nuclear test, has found a more effective means of persuasion. Anbound, a Beijing-based consultancy, says it believes that China's crude oil exports to North Korea dropped considerably in September, even before the nuclear test. But a Chinese foreign-ministry spokesman said this week that he had not heard of any change in China's policy of helping North Korea cope with its shortages of food and energy.

A turning-point, as China would like to portray it, was a visit to Pyongyang by its special envoy, Tang Jiaxuan, last month. Mr Tang met Kim Jong Il and appealed for a return to the six-party talks.

North Korea may also have been encouraged by American willingness to talk directly. Mr Hill's discussions in Beijing involved some bilateral talks with North Korea's deputy foreign minister, Kim Gye Gwan. One of the main aims of North Korean foreign policy has been to engage the Americans without intermediaries. Mr Hill said his talks in Beijing were within a trilateral “framework” and that he told the North Koreans that America did not recognise their country as a nuclear state. But North Korea's official news agency said the “main emphasis” of the talks was bilateral.

North Korea's habitual mood swings may yet scupper the talks. Nor has there been any hint that it may

be ready to offer concessions: it has made no promise to refrain from testing another bomb or more missiles. Mr Hill said North Korea had reaffirmed a pledge to give up its nuclear-weapons programmes in return for energy supplies and security guarantees. But America and North Korea have very different views of what steps should be taken to achieve this, and how nuclear dismantling should be verified. With its bomb-making ability now demonstrated, North Korea may well feel it has little to lose by appearing a little more talkative.

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Chinese summitry

On safari

Nov 2nd 2006 | BEIJING
From The Economist print edition

Practising for the Olympics

THE hoardings along every main street of central Beijing look like an effort to promote a new safari park: billboards are plastered with giant photographs of elephants, giraffes, lions and zebras. Images of half-naked, exotically painted tribesmen adorn the capital. It is part of China's lavish welcome for the leaders of most of the African continent, who have been gathering in Beijing this week for the biggest diplomatic jamboree in the country's history. Stereotyping has not, apparently, been a worry for the hosts.

The scale of the first China-Africa summit, attended by more than 40 heads of state and government, far exceeds any diplomatic event ever held in Beijing. The gathering, from November 3rd to 5th, is being presented by China as a demonstration of its rapidly expanding ties with Africa (driven mostly by its demand for African oil and other natural resources), as well as of its organisational abilities ahead of the Beijing Olympics in August 2008. Earlier in the same week, China hosted a summit of ten leaders from the Association of South-East Asian Nations in the southern city of Nanning as well as talks with North Korean and American officials (see article). For a country still finding its feet as a global diplomatic player, these events have been an exceptional workout.

Reuters

China goes wild

An article this week in *Beijing Daily*, the main propaganda organ of the city government, suggested the extent of the cultural gap between China and many other parts of the world, despite its rapidly growing economic and diplomatic engagement. As for our African friends, it said, some people still think of them as coming from underdeveloped countries, and "lack knowledge of Africa's ancient history, magnificent culture and recent development". During the summit, no matter what colour or how few clothes African visitors might wear, citizens should not surround them or photograph them without their permission, said the newspaper.

The city authorities have been almost as crude in their efforts to ensure the smooth flow of the capital's normally gridlocked traffic during the event. For the first time in advance of a big event, the government has published regular updates of how traffic will be managed. But it has also resorted to some heavy-handed techniques: banning out-of-town vehicles from urban Beijing and removing beggars from busy areas and around summit venues. In September officials denied a report in a state-owned newspaper in the capital that 1m migrant labourers in Beijing would be expelled from the city before the 2008 Olympics and that the mentally ill would be confined to hospitals. But the denial has done little to allay suspicions that such tactics will be used.

China has been more considerate, however, of the sensitivities of the visiting African leaders. The official media have avoided dwelling on the humanitarian crisis in Sudan, whose president, Omar al-Bashir, is among Beijing's guests. The official news agency, Xinhua, published an interview with Robert Mugabe of Zimbabwe making no mention of the human-rights abuses that have made him a pariah in other parts of the world. He would probably do the same for China.

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Indonesia's criminals

Lucky Tommy

Nov 2nd 2006 | JAKARTA
From The Economist print edition

Did the punishment fit the crime?

LIFE has always been pretty good to Hutomo Mandala Putra, the flamboyant youngest son, better known as Tommy, of Indonesia's former dictator, Suharto. When he was arrested in 2001 for ordering the murder of a judge who had convicted him of graft, many expected him to spend decades behind bars. Not only had the former owner of the Lamborghini car company ordered the killing, he went into hiding rather than serve his 18-month corruption sentence.

But Mr Hutomo is already free on parole. On October 30th he walked out of prison thanks to a system which, critics argue, still favours the rich and powerful. Mr Hutomo was given 15 years, a fraction of the maximum possible life sentence, for paying two hitmen to gun down the judge. His jail term was slashed to ten years on appeal, and further reduced for good behaviour. After the latest reduction, to mark the Muslim festival of Eid, Mr Hutomo had served more than two-thirds of his sentence and was eligible for conditional release.

Most Indonesians convicted of murder receive much harsher sentences and see their appeals fail. Few get the privileges afforded to Mr Hutomo, such as his own specially expanded cell from where he oversaw his business empire.

The failings of the judicial system were exposed earlier last month as well. The only person convicted in connection with the 2004 murder of a prominent human-rights activist, Munir Thalib, was freed on appeal. Mr Hutomo's release came in a week when hundreds of potential foreign investors descended on Jakarta for a big government conference seeking to boost Indonesia's rickety infrastructure by inviting bids for billions of dollars-worth of projects. A big reason for the failure of a similar event in January 2005 was that investors were scared away by Indonesia's legendary lack of legal certainty.

Punishing murderers is different from enforcing contracts, and there have been some much-needed reforms in the past 18 months. But Mr Hutomo's case makes it all too obvious that legal reform is still very much a work in progress.

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Thailand

Thaksin, the comeback kid?

Nov 2nd 2006 | BANGKOK
From The Economist print edition

The coup chiefs struggle to pin something on him

Get article background

LIKE Elvis Presley in the late 1960s, could Thailand's deposed prime minister, Thaksin Shinawatra, make a spectacular comeback? Six weeks after the country's military chiefs seized power during Mr Thaksin's absence abroad, a glowing biography in the form of a comic book, “Life of Thaksin”, has appeared. Its last frame promises: “the champion of the poor will not desert them...he will return.”

Mr Thaksin flew to China this week, in an apparently fruitless attempt to seek permission to go home from General Surayud Chulanont, Thailand's interim prime minister, who was there for trade talks. Mr Thaksin's wife Potjaman, however, has returned to Bangkok. On October 26th she met King Bhumibol's chief adviser, Prem Tinsulanonda, seen by some as the brains behind the coup, to ask if her husband could return. The day before, the army denied reports that it had brought extra troops to Bangkok in case the deposed leader did try to make a comeback.

Who will come back first: Thaksin or the King?

After several name changes, the military junta now calls itself the Council for National Security. It has ostensibly handed most powers to General Surayud and his cabinet of technocrats. But it has still not lifted martial law or a ban on political activities, fearing a rebellion among Thaksin fans in the security forces. The junta justified the coup on the ground of “rampant corruption” in Mr Thaksin's government, but admits it has failed so far to find damning evidence against him. So it is wavering over its promise that Mr Thaksin may come home whenever he wants.

Mr Thaksin has resigned as leader of his Thai Rak Thai (TRT) party, many other leading figures have deserted it, and it faces a court case that could mean its dissolution. But its caretaker leader, Chaturon Chaisang, says he is trying to keep the party going while reviewing some of its controversial policies, such as privatisation. TRT will seek reconciliation with other democratic forces, says Mr Chaturon, not confrontation. Mr Thaksin's lawyer has said his client will return and may re-enter politics when martial law is lifted.

Until this week, when they condemned reports that some coup leaders were thinking of forming a political party, the second-largest party, the Democrats, had kept a low profile. Surin Pitsuwan, one of the party's senior figures, argues that it would be counter-productive for them to press their demands too vociferously at the moment. But he predicts there will be protests if the army and its appointed government fail to live up to expectations. Already, the Thai press is becoming bolder—for instance, by criticising Mr Prem for meeting Mrs Thaksin.

An interim parliament, heavy with bureaucrats and military men but with few party representatives, has started work. Some of Mr Thaksin's policies, such as cheap health care and microfinance for rural villages, may prove too popular to scrap. Another senior Democrat, Korn Chatikavanij, acknowledges that Mr Thaksin and TRT introduced a novel and worthwhile idea to Thai politics—that parties should have clear policies.

However, the constitution-writing body the generals are setting up may engineer a return to the days without strong parties and real policies. During Mr Prem's premiership in 1980-88 most things were

settled in back-room deals. This would probably suit the military-palace elite now in control of Thailand. But Premocracy is no substitute for real democracy.

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Israel and the Palestinians

Military solutions in the air

Nov 2nd 2006 | JERUSALEM
From The Economist print edition

As Israel reoccupies a town in Gaza, Islamist control of the Palestinian Authority may be threatened

Reuters

COULD Gaza, or part of it, be about to be reoccupied? Early on Wednesday morning, Israeli tanks backed by helicopter gunships entered Beit Hanoun, one of the larger towns in the northern part of the Gaza Strip; fighting was also reported from nearby refugee camps. After weeks of raids and bombardment, Israel's tanks seemed poised at mid-week for a bigger battle.

The aim, say Israeli officials, is to end the barrage of makeshift rockets lobbed into Israel from Gaza and stop the arms smuggling across the Egyptian border which, they say, could soon enable Hamas to field a Hizbullah-style anti-tank force. The rockets from Lebanon had, after the summer war there, to be silenced by a formal ceasefire. But Gaza is different. Some Israeli officers reckon a knock-out blow could make the strip more like the West Bank, where armed resistance is all but a spent force and the Palestinian Authority (PA) exists in little but name.

Beyond that, Israel's undeclared endgame may be to oust the Islamists from control of the PA. The Hamas regime has already been weakened by the debilitating international sanctions imposed since its refusal to recognise Israel or honour previous PA agreements with the Jewish state. Denied Israel's customs transfers, hitherto the PA's prime source of revenue, the government is unable to govern.

Its revenues have plummeted, says the IMF, down to $500m in the first six months of Hamas's tenure from $1.2 billion in the same period last year. Of that 80% comes from Arab and European donors and bypasses the government's coffers. With Gaza's land and sea borders under military siege, the economy has nose-dived, shrinking the available tax-base. What little is raised is largely taken by Palestinian banks, anxious to recoup their debts before the PA goes into receivership. Israel's military strikes have hastened the decline. Since Hamas (and other) guerrillas burrowed across the border and captured an Israeli soldier last June, Israel claims to have killed some 300 Palestinian fighters in Gaza—but the Palestinians say many of those were civilians. The attacks have destroyed Gaza's power plant, and left many of its ministries and bridges in ruins.

Meanwhile, Palestinian leaders continue to squabble over whether Fatah or Hamas should rule. Proposals to establish a national unity government are stymied by the refusal of either faction to serve as junior

partner. With politics deadlocked, an unofficial alliance between Fatah, Israel and the United States has begun to consider a military way to force Hamas out. In the name of “security reform”, America is financing a training camp outside Jericho for the Palestinians' Force 17, a recruitment pool for the presidential guard. Israel has sanctioned the transfer of heavier weapons and allowed Fatah's Tanzim militia to rearm. The Palestinian president, Mahmoud Abbas, awaits the arrival of 2,000 troops from the Badr Brigade, a Jordan-based division of the Palestinian Liberation Army which operates largely under Hashemite command. These troops, say the president's advisers, would provide the backbone of a force of tens of thousands to take on Hamas, whose own forces are said to number 5,700 in Gaza, and 1,500 in the West Bank.

But the numbers could be deceptive. While on paper Fatah has much the bigger force, its loyalties are so divided by clan, paymasters and politics that its allegiance to Mr Abbas cannot be assumed. Despite the animosity between Fatah and Hamas, precedent suggests that, in the face of a big Israeli offensive, many Fatah troops would join their fellow Palestinians. And though the Badr forces from Jordan sound like a strong reinforcement, they are seen by many Palestinians as something of a “Dad's Army”, untested for 35 years.

By contrast, Hamas's Executive Force is battle-trained, disciplined and equipped with anti-tank missiles. A series of assassinations of senior men, apparently orchestrated by Hamas, mean that in Gaza Fatah's most effective security forces rarely emerge from their parapets. Even in Khan Younis, the stronghold of Fatah's stongman, Muhammad Dahlan, Hamas's forces dominate during the nights.

Nor is the commander-in-chief, Mr Abbas, the leader his backers would like him to be. Though flush with Arab aid and American military support, Mr Abbas has failed to rally his troops. He has issued so many ultimatums to Hamas to accept his terms that even his closest advisers have begun to talk of crying wolf. The internal rivalries that cost Fatah the election last January remain pronounced. In mid-October the president failed to persuade Fatah's Central Committee to meet under his baton. And Fatah's public reputation for cash-for-compliance has been enhanced by its identification with what Palestinians see as the American and Israeli campaign to cancel the democratic choice they made when they voted for Hamas.

What happens next? One danger is a complete breakdown of central authority. Western and Arab donors, anxious to preserve a structure in which they have invested over $10 billion, have almost doubled their injections of aid this year to $420m to stave off collapse. There is a slim chance that Hamas might yet bow from power with its “principle” of rejecting recognition of Israel intact, making way for a non-Islamist government. But with the territory's elected representatives excluded from international diplomacy, economically cornered and subject to military attack, a fresh round of fighting must be reckoned the more probable scenario.

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Libya

Bad blood

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From The Economist print edition

What will persuade Libya of the flimsiness of the evidence against the nurses?

AFP

IT IS hard to know which is more tragic. Is it worse that a hospital should infect hundreds of children with AIDS and that scores of them should die from the incurable disease? Or that some of its staff should be accused of their murder and sentenced to death by firing squad?

This is not the only moral dilemma that a Libyan judge now faces in the final appeal of five Bulgarian nurses and a Palestinian doctor who have been held for seven years on this sickening charge. He must also determine what kind of a country Libya is. Is it a place where justice is impartial and seeks the truth? Or does it remain a country where ignorance, prejudice and pressure to shield powerful people from blame trump glaring scientific evidence?

So far the answer has been pretty clear. In 1999, after a local newspaper exposed a mysterious AIDS outbreak among children treated at the state-run Al Fateh hospital in Benghazi, Libya's second largest city, the police swiftly rounded up medical workers. Eleven Libyan hospital administrators and 17 foreigners were eventually released. But, amid calls for vengeance by the children's distraught families, the five recently hired Bulgarians and Ashraf Hajouj, a Libyan-born Palestinian doctor, were charged not just with negligence, but with deliberately infecting the children as part of a genocidal espionage plot.

That charge was eventually dropped, but replaced with a similarly outlandish one, that the six had been experimenting with an anti-retroviral drug on live patients on behalf of some unnamed foreign drug company. Several of the defendants confessed to having done this, but later retracted the confessions, saying they had been extracted under torture. Witnesses who had been held in the same prison concurred that they had seen the medical workers being beaten, electrocuted and threatened with dogs.

No fewer than three reports commissioned by the Libyan government from distinguished foreign experts cleared the nursing staff of personal responsibility. The probable cause they cited instead was the generally deplorable state of hygiene in the hospital. Among other evidence, French, Swiss and Italian experts noted that the AIDS outbreak appeared to have started at least a year before the accused nurses arrived in Libya and continued after their arrest. In addition, more than half the blood samples taken from HIV-infected children showed they had also been infected with other diseases, including several variants of hepatitis.

The obvious culprit in this case was the re-use of unsterilised needles. This has, in fact, been the cause of similar AIDS outbreaks, such as one in Russia in 1989 that infected 274 children. In Egypt during the 1970s and 1980s, a poorly controlled nationwide campaign to treat the parasitic disease bilharzia by

multiple drug injections led to the massive spread of hepatitis C. Some 6m Egyptians are currently infected, largely as a result of the campaign. Even in the United States, some 20,000 patients die every year from infections contracted inside hospitals.

Libya's courts have refused to consider such evidence on the grounds that it contradicts the conclusions of a panel of Libyan doctors. The alleged discovery of vials containing AIDS antibodies in the home of one of the nurses, the Libyan doctors contend, is proof enough of criminal intent. Yet even by the Libyans' account, those vials were only analysed four years after being collected and did not show the presence of HIV, but of antibodies to the virus.

Testimony from other health workers amply illustrates the poor state of public health services in Benghazi, a city which, incidentally, has long been a centre of opposition to Muammar Qaddafi. Some Libyan exiles suggest the city may have been kept short of medical supplies as punishment for an Islamist insurrection in the mid-1990s. They also contend that Libya's ruler has used the case to stoke xenophobia as a way of bolstering his rule.

An international outcry greeted the death sentences handed out by a lower Libyan court in May 2004, followed by relief when the supreme court ordered a retrial the following year. Yet the grinding slowness of the retrial, and the continued refusal to consider expert opinion, have lowered expectations that the verdict, expected within weeks, will be fair.

European governments have not publicly responded to Libyan hints that “blood money” might secure the defendants' release. But a flurry of quiet diplomacy suggests some attempt at deal-making. A fund has been established to help the AIDS victims and the families of the 52 children who have died so far. And within the past two months nearly 400 sick children have been flown to European hospitals. Several governments are also dangling military contracts. Perhaps that is what it takes to make Libyan justice work.

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Syria

Sir Nigel goes fishing

Nov 2nd 2006
From The Economist print edition

Baathist dictator makes new friend

WOULDN'T it be neat if the West could somehow peel Syria away from its anti-American alliance with Iran and so help to stabilise Lebanon, calm Israel's relations with the Palestinians and cut off some of the supply routes for Iraq's foreign jihadists? That, presumably, was the reason why Tony Blair, Britain's prime minister, sent a senior adviser, Sir Nigel Sheinwald, to Damascus this week for a meeting with the Syrian president, Bashar Assad.

There is only one fly in this plan's ointment: Bashar Assad. Syria's president may be less cunning and murderous than his late father, Hafez, but he is nobody's pushover. Less than two years ago he looked weak and susceptible to pressure. Many people assumed that he ordered the killing of Lebanon's former prime minister, Rafik Hariri, in February 2005. That prompted a UN inquiry and a popular storm in Lebanon that forced Syria's army into a humiliating withdrawal. There was loose talk in Washington about making his the second Baathist regime to be toppled by America. And it was assumed that Mr Assad knew that in any military clash with Israel Syria would be swiftly routed.

Now all has changed. This summer has seen rising American fatigue in Iraq, a war in which Hizbullah, Syria's protégé, made Israel look weak, and the tightening control of Damascus-based Palestinians over the Hamas government in the West Bank and Gaza. Iran, far from being cowed by American threats, is in a bumptious mood. Sir Nigel would have had to take some very tempting morsels to Damascus in order to entice Mr Assad out of Iran's orbit.

Mr Assad would like the UN to stop investigating Syria's role in the Hariri assassination, a guarantee that America will not try to undermine his regime, a return of Syria's influence in Lebanon and the return of the Golan Heights, which Israel captured in 1967. Sir Nigel, a talented diplomat, is tipped to become Britain's next ambassador to the United States. But it is hardly in his gift to proffer any of these enticements—unless, of course, this was a fishing trip conducted at America's behest.

Mr Assad is not popular in the White House. But some in the State Department think the West has much to gain in Lebanon, Iraq and Palestine by splitting Damascus from Tehran. Both America and Israel knew in advance about Sir Nigel's expedition—and it was the British, remember, who talked round Libya's Muammar Qaddafi. Watch this space.

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Nigeria

Choose your airline carefully

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Your life may depend on it

IT WAS a dreadful week for a country with lofty ambitions to transform itself into a regional aviation hub. On October 29th a Boeing 737 of ADC Airlines, a domestic Nigerian carrier, lost control shortly after take-off from Abuja, the capital, and ploughed into a nearby field. Among the 96 dead was Muhammadu Maccido, the spiritual head of Nigeria's 70m Muslims, also known as the Sultan of Sokoto. The crash was the third big passenger-aircraft disaster in a year, coming just a month after a military plane came down, killing ten of the army's top generals.

Nigeria's aviation minister, Babalola Borishade, was quick to apportion blame, saying that the pilot had flown into a storm, ignoring warnings from the control tower not to take off. But like previous statements by aviation-ministry officials giving specific reasons for the disasters, such as poor weather or bad runway lighting, the minister's comments enraged Nigerians. Many blame government incompetence and corruption for the death of more than 300 people in the three airline crashes. What is more, President Olusegun Obasanjo seems to agree with them. “The greatest bane of the aviation industry is corruption,” he said last year. “There's a lot of corner-cutting, at the expense of precious lives of Nigerians.”

Reuters

Another one bites the dust

Roland Iyayi, director of the Nigerian Airspace Management Agency, argues that the disasters demonstrate “systemic failures”. In October 2005 an aircraft operated by Bellview, another popular local carrier, crashed, killing 117 people. But the wreckage was not located for 15 hours. Two months later, an aircraft operated by Sosoliso, another local airline, crashed and caught fire, killing over 100 people, many of them children. A lack of fire hydrants at the airport meant that many burned to death unnecessarily. “Certain rescue facilities and emergency-response capabilities simply do not exist,” says Dung Pam, chairman of the Nigerian Aviation Safety Initiative, a lobby group.

Nigeria earlier this year set aside an emergency fund of $150m to improve its airports, including vital navigational equipment and runways. But people doubt whether the money will be spent wisely. One government aviation agency recently spent $1m on cutting grass at the airport at Lagos, Nigeria's biggest city.

All this will be looked at closely when auditors from the International Civil Aviation Organisation (ICAO) come to Nigeria later this month to see whether there has been any progress on regulatory and infrastructure reform. In particular, they will be keen to learn whether an aviation bill, designed to give regulatory agencies autonomy from the meddling aviation ministry, will be passed and implemented.

This is vital given how much political interference there has been. Laws to weed out airlines that are indebted or running on shoe-string budgets have yet to be implemented, with some airlines surviving just because of political connections. Contrast that with what happened to Slok Air, owned by a Nigerian governor particularly vocal in his distaste for Mr Obasanjo. In 2004 the airline lost its licence to operate for an offence that industry sources say is normally punishable by a fine. It had to relocate to Gambia.

If Nigeria does not satisfy the ICAO auditors, other countries, including the United States, could consider restricting the entry of Nigerian-registered airlines. This would be a severe blow to an ambitious aviation

industry that has seen annual passenger numbers double to 8m over the past seven years, the crashes notwithstanding. It could also penalise airlines with good safety records such as Virgin Nigeria, owned by Nigerian investors, and Richard Branson's Virgin Atlantic, which has expanded rapidly in the past year.

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P.W. Botha

The “crocodile” slips away

Nov 2nd 2006
From The Economist print edition

Few mourn the death of an unrepentant symbol of apartheid

AP

Get article background

ANOTHER page of history has been turned in South Africa. P.W. Botha, who led the country from 1978 to 1989 at the height of the anti-apartheid struggle, died on October 31st at the age of 90. Listening to the messages of condolence to his family from his former adversary, Nelson Mandela, and President Thabo Mbeki, it may seem strange to recall that he was once utterly reviled in South Africa and abroad. An unrepentant hardliner of irascible temper, Mr Botha—known as the “great crocodile”—never apologised for the evils of apartheid. Yet Mr Mandela, faithful to his undying spirit of reconciliation, credits him for playing a critical role in bringing them to an end.

As prime minister and then president Mr Botha did start dismantling the structure of apartheid by repealing its most abhorrent laws, and he was the first apartheid leader secretly to meet Mr Mandela while the latter was still in prison. He also initiated limited power sharing with the Indian and coloured communities, which sidelined the most far-right elements of the Afrikaner Nationalist Movement. But he balked at the final move of releasing Mr Mandela and handing over to a government elected by universal suffrage.

He also never made any excuses for apartheid. In the 1980s the finger-wagging Mr Botha used increasing force to suppress black protest in the townships, declaring a state of emergency in 1986 and bringing the country to the edge of civil war. He claimed that he knew nothing about the torture and killings perpetrated by his own security forces at a time when police detainees had a propensity to fall out of windows. Mr Botha refused to appear in front of what he called the “circus” of the Truth and Reconciliation Commission set up in 1995 to help heal the wounds of apartheid by the first government run by the African National Congress. He was convicted of holding the commission in contempt but successfully appealed.

Born on a farm, P.W. was a quintessential Afrikaner. His mother suffered in the British concentration camps during the Boer War. He was first elected to parliament when the National Party, which introduced apartheid, came to power in 1948. Following several ministerial jobs, he became prime minister in 1978 and later president. It was his successor, F.W. de Klerk, who applied the *coup de grâce* to the moribund regime that he had left behind, releasing Mr Mandela in 1990 after 27 years behind bars and organising the country's first fully democratic election, which swept the African National Congress to power in 1994.

In contrast to the conciliatory condolences from the ANC leadership, the Pro-Afrikaans Action Group, an outfit campaigning for Afrikaner rights and culture, which they consider under threat, said this week that Mr Botha may eventually be seen in a more benign light. If South Africa's democracy takes root, they say, his critics will be proved partly correct; but they argue that the country may yet go the way of Zimbabwe, in which case they think he will be judged otherwise. For the present, however, few South Africans are shedding any tears over the symbol of an era that most are trying to forget.

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Congo

Down to the wire?

Nov 2nd 2006 | KINSHASA
From The Economist print edition

The presidential run-off proves to be closer than expected

AFTER the polls closed in the capital, Kinshasa, and counting began by candlelight, one name rang out over and over again. As expected, the former rebel leader, Jean-Pierre Bemba, had registered a huge lead on his home turf, much to the delight of the throngs of angry young voters he has won over in recent months. Thousands of kilometres to the east, the incumbent president, Joseph Kabila, has, as in the first round, won huge support from fellow Swahili speakers who credit him for bringing relative peace to Congo.

The historic vote on October 29th gave Congolese the chance to choose their president freely for the first time in over four decades. It passed off relatively peacefully, although voting is being re-run in several towns where the ballot was disrupted by deadly clashes. But against the scale of Congo's previous conflicts, these were considered minor.

Official results will take some time as ballot papers and results sheets must be ferried by foot, motorbike, pirogue and plane to counting centres across the vast country. Inevitably, rumours and fake results have already begun spreading, upsetting election officials who fear that they may lead to violence in a city that feeds off gossip.

Amid the uncertainty, however, one thing appears to be clear; the result is much closer than many people had expected. Having won 45% of the vote in the first round, compared with Mr Bemba's 20%, Mr Kabila was a clear favourite to win. But a lower turn-out in the east means that he has lost votes that should have been in the bank. And important allies appear not to have delivered. One, François Joseph Mobutu Nzanga, a son of the late dictator, Mobutu Sese Seko, who was supposed to bring in votes in the west, failed to convince even those living in his hometown to vote for Mr Kabila. Days before voting he had to be rescued by UN peacekeepers after gun battles with Mr Bemba's men. On the other hand, Mr Bemba's allies appear to have convinced many in the two Kasai provinces, an opposition heartland that has largely boycotted the electoral process so far, to vote for him.

But, as one UN official says, “If the margins are small, the irregularities start to matter and the results are more likely to be challenged.” That could easily escalate to the sort of violent clashes that followed the first round of voting. With widespread reports of re-arming by both sides' private armies, UN and EU

peacekeepers are taking no chances and have reinforced their presence in the capital.

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Correction: Americans in Iraq

Nov 2nd 2006

In our editorial on Iraq last week (see article) we said that some 2,200 American soldiers had been killed in Iraq. Inside the paper (see article) we put the number at some 2,800. We should have explained that the first number comprises only those killed in hostile action, whereas the second includes accidents and illnesses. Sorry.

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Serbia and Kosovo

A province prepares to depart

Nov 2nd 2006 | BELGRADE AND PRISTINA
From The Economist print edition

Despite its last-minute manoeuvring, Serbia now seems certain to lose Kosovo

Get article background

WHAT you see is not always what you get. Serbia has a new constitution stating that Kosovo is an inalienable part of the country. Serb leaders told their people that, if they voted for the constitution in a referendum on October 28-29th, it would speed their entrance into the European Union. But as *Danas*, a Serbian daily, noted tartly, “They promised a Kosovo in Serbia and a Serbia in Europe. It is hard to tell which is further away.” Politics in the Balkans has been going through a surreal phase—but reality is around the corner, in the form of Kosovo's independence.

Serbia has needed a new constitution ever since the fall of Slobodan Milosevic in 2000. The old one was designed when Serbia was part of a bigger country, with Montenegro. How odd then that, when Martti Ahtisaari, a former Finnish president who was asked by the United Nations to oversee negotiations between Serbs and Albanians on Kosovo's final status, said he would present his plans at the end of October, Serbia's leaders should have rushed a new constitution through parliament with almost no debate.

The leaders of all main parties rallied to the cause, asking people to vote in the referendum, which needed a 50% turnout to be valid. An aggressive campaign was launched, with millions of text messages sent out to remind people to cast their ballots. Yet only 55% actually voted, many of them late in the day. Suspicious eyebrows were raised; one politician who had called for a boycott declared that he did not believe the threshold had been reached. But given the chaos that a failed vote would have caused, nobody of significance was prepared to question its validity.

The reason for holding the referendum now was to delay, even by a few months, the loss of Kosovo. The idea is that, with the constitution adopted, Serbia will hold an election before Kosovo goes, stopping the extremist Radical Party from picking up more disaffected votes. This has been accepted by Mr Ahtisaari and other diplomats dealing with the Balkans. The election may be held in December. Serbia's president, Boris Tadic, wants a presidential election too, but this is being resisted by the prime minister, Vojislav Kostunica. He fears that Mr Tadic's popularity might pull in votes for his Democratic Party, reducing Mr Kostunica's chances of becoming prime minister again.

Serbian leaders also argued that a vote for the constitution would tell the world that Kosovo belonged to Serbia and should never be given independence. Most Serbs would like that to be true. But opinion polls show that few believe independence can be prevented. “Lies, lies, lies,” commented a taxi driver as he passed a billboard demanding a yes vote to keep Kosovo. “It was lost years ago.”

Since the war of 1999 Serbia's southern province has been under the jurisdiction of the UN. Some 90% of its 2m people are ethnic Albanians who want nothing short of independence. Yet, ever since Mr Ahtisaari began his talks last February, Mr Kostunica has been repeating that Kosovo will never be independent. Now it seems he may have been playing a cleverer hand than some have thought.

What seems to be happening is that his government, the Kosovo Albanians and the outside powers involved (the “Contact Group”) are moving towards a messy and perhaps temporary solution. The scenario goes as follows. With Serbia holding an election in December, Mr Ahtisaari puts off presenting a final version of his plan to the UN Security Council. When he does so, it will suggest that Kosovo becomes independent but with limits placed on its sovereignty for some years to come. An EU team is in Pristina planning a mission to take over from the present UN one, which will be wound up. The EU is planning a similar set-up to the way Bosnia has been run since 1995. A post will be created called, probably, the International Civilian Representative, who will at the same time represent the EU. As in Bosnia, the job will come with considerable powers to intervene in the running of Kosovo. The NATO-led force now in place will remain.

Right now, says Enver Hoxhaj, a member of the Kosovo Albanian negotiating team, “The real talks have...begun. They are not between Pristina and Belgrade, but between the members of the Contact Group.” The key ones are the Americans and the British, who support independence, and the Russians, who do not. Trade-offs between them are being proposed, some involving issues unrelated to the Balkans, such as Iran. But what is expected to be agreed by the end of March is a new UN resolution that avoids using the word “independence”. At this point Kosovo's parliament will declare independence unilaterally. Some, perhaps most, countries will recognise the new state—but others, including Serbia, will not.

Kosovo's Albanians will be happy with this—but they will have a bitter pill to swallow too. The Serb-inhabited north of Kosovo (north Mitrovica and beyond) will ignore independence and continue to operate as it does now—which is, in effect, as part of Serbia. Whether Serbs in the rest of Kosovo then choose to flee depends on what happens. In the long run Mr Kostunica may hope for a formal partition. Some Albanians would like that, but only if they get Albanian-inhabited parts of south Serbia in exchange. Partition, sighs one diplomat, is “the love that dares not speak its name”. If Kosovo can be partitioned, why not Macedonia and Bosnia?

Kosovo Albanian politicians seem curiously resigned to losing control of the north. Many think that, in the long run, Serbia will be forced to recognise the new Kosovo's territorial integrity as the price it has to pay to join the EU. In the short run, it is fashionable also to refer to the Irish precedent. Until 1999 the Irish Republic claimed the whole island of Ireland under its constitution, but it did not act on it. A future Serbia, with Kosovo still enshrined in its constitution, could take the same approach. If it does not, says Milica Delevic-Djilas, head of Perspektiva, a new think-tank meant to produce ideas about the Balkans and European integration, “It's the end of regional co-operation and of our aspirations for the EU.”

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Ethnic groups in Kosovo

The minorities within the minority

Nov 2nd 2006 | BROD
From The Economist print edition

Kosovo is lived in by others besides dominant Albanians and minority Serbs

Get article background

HAMDIJE SEAPI, a local Gorani official, excuses himself to go to the funeral of a woman from a neighbouring village. He did not really know her, but since her village was all but abandoned in 1999, somebody has to. In his village, Mlike, there were 1,380 people before the Kosovo war, but now there are barely 400, 70% of them over 65. “Before, we were somehow like shock absorbers between Serbs and Albanians, but now we have our backs to the walls.”

The Gorani are among the smallest of Kosovo's minorities. Before the war, say officials, anywhere up to 18,000 of them lived in Gora, a rural sliver of land squeezed between Macedonia and Albania. Now a mere 8,000 remain. They are Muslims, living in villages in the remote south and speaking a language close to Serbian and Macedonian. At school they have always been taught in Serbian. Many of them were loyal Serbian citizens, serving in the police and as officials until the end of the war in 1999.

This has incurred much enmity from Kosovo's Albanians. Since 1999 Serbia has continued to pay Gorani teachers like Serbian ones, and they have continued to use the Serbian curriculum. Now the Kosovo authorities want to force them to change. If they did, Gorani children could not go to Serbian secondary schools. Serbia pays its teachers in Kosovo at least twice what the Kosovo authorities do. As a result of this dispute, several hundred Gorani children are now locked out of their schools.

In the village of Brod, locals still burn manure for fuel. Hakija Cuculj, a member of the local council, says that since the UN took over in Kosovo it has redrawn local boundaries so that Gorani are now outvoted on everything by Albanians. Immediately after the war many Gorani left for Serbia; now they go farther afield. Mr Cuculj's son works in Italy and sends home money. “People are just living in uncertainty,” he says. “They just want to survive.”

There are no reliable figures for anything in Kosovo. But a rule of thumb is that some 90% of the province's 2m people are Albanians. At least half of the remaining 200,000 are Serbs. The biggest minority after that are local Slav Muslims, many of whom, since 1999, have chosen to identify themselves as Bosniaks (ie, Bosnian Muslims). Then come Roma, some of whom are called Ashkali and some Egyptians; Turks; Gorani; and, finally, a tiny number of Croats. Since the early 1990s most Croats

have left, many to settle in places in Croatia from which Serbs have fled. The Gorani are now the smallest of the small.

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Ukraine's politics

Up for grabs

Nov 2nd 2006 | KIEV
From The Economist print edition

The birth-pangs of democracy, or an unseemly power struggle?

WHEN Ukraine emerged from the dying Soviet Union there were some, especially in Russia, who said its independence was provisional, and its destiny was to be swallowed up by its neighbours. During the "orange revolution" of 2004, which swept Viktor Yushchenko to Ukraine's presidency, the threat of dismemberment was revived by supporters of Viktor Yanukovich, his Russian-backed rival. That talk has receded, but all else in Ukrainian politics continues to be provisional.

Mr Yanukovich's status as a disgraced election-rigger was temporary. After his party won most seats in parliament last March he again became prime minister, the job he held before the revolution. Other old faces have returned with him. Under new, possibly provisional, constitutional arrangements, the job carries increased powers that overlap with the president's. Oleksandr Chaly, deputy head of the presidential administration, says that all democracies go through transitional periods in which the powers of various arms of government are defined. But in Ukraine the process looks less like constitutional fine-tuning than a revived power struggle.

AP

Viktor loses the spoils

So far, says a Western diplomat in Kiev, "the prime minister is winning". The constitution makes the president responsible for foreign policy, but that did not stop Mr Yanukovich saying, on a trip to Brussels, that Ukraine's integration into NATO should be delayed. Despite Mr Yushchenko's urgings, parliament is stalling over the legislation needed for Ukraine to join the World Trade Organisation (WTO). Last week José Manuel Barroso, president of the European Commission, admitted that neither the European Union nor Ukraine was ready to talk about Ukrainian accession to the EU.

Mr Chaly insists that there are "no strategic differences" between the two Viktors. Yet the course of Western integration that Mr Yushchenko had set may turn out to have been provisional. Mikhail Fradkov, Russia's prime minister, was in Kiev just as a new deal was being reached on Ukraine's gas imports. Ukraine faces a rise in the price of gas it buys from Russia and Turkmenistan in 2007, though not as sharp as it feared. The prospect of a renewed gas crisis, in which supplies to Ukraine could be cut off as they were last January, seems to have been averted.

But the deal is temporary and opaque, and rumours swirl over what concessions the Russians have extracted in return. Mr Fradkov talked of the two countries "synchronising" their WTO bids (the Russians fret that Ukraine might get in before them). Mr Yanukovich mooted the possibility of Russia's Black Sea fleet staying at Sebastopol, its Crimean base, after its lease runs out in 2017. Mr Yushchenko's line, repeated again this week, was that it would have to go. The bigger fear is that Kiev's control of Ukraine's gas-pipeline network may be provisional too.

So might be the uncomfortable cohabitation of the two Viktors. Our Ukraine, the president's party, last month broke off coalition negotiations with Mr Yanukovich's lot—talks that, somewhat incredibly, had been going on ever since March. Several ministers whom Our Ukraine had provisionally nominated to the cabinet have now tendered their resignations—even though murmurs about restarting the talks are growing louder. Mr Yanukovich's coalition still has a parliamentary majority, but its odd combination of Communists and business tycoons may prove unstable. (Like so many revolutionary alliances, the "orange" team, led by Mr Yushchenko and Yulia Tymoshenko, was purely tactical and has now collapsed.)

Some in MrYanukovich's team see Mr Yushchenko himself as a temporary president. He has brought some tough businessmen into his administration. But his popularity is now so low that his chances of winning the next presidential poll, in 2009, look slim. A few crowd-pleasing arrests of corrupt former officials would buoy up his ratings; but it seems that his campaign promises of justice were themselves provisional. Whether the real gains of the revolution—freer media, cleaner elections and competitive politics—prove more lasting remains to be seen.

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Italy's government

Tantalising

Nov 2nd 2006 | ROME
From The Economist print edition

The centre-left holds on for now; can Silvio Berlusconi?

FOR Silvio Berlusconi it must seem like the torture of Tantalus, whose punishment by the gods was to have food and drink always hovering out of his reach. Ever since he was replaced as prime minister by Romano Prodi after April's election, it has looked as if the new centre-left coalition might disintegrate; and never more so than in the past couple of weeks, as ministers and coalition deputies and senators have fallen to squabbling over the details of next year's budget.

Yet on October 28th Mr Prodi chaired a summit of coalition bigwigs who once again papered over the cracks. There seems now to be a reasonable chance that the centre-left will stay in office at least long enough to complete the stupendously tortuous process of approving an Italian budget—which means until the end of the year. That is bad news for Mr Berlusconi, for it is becoming ever clearer that his chances of regaining office are inversely proportionate to the longevity of the present government.

On October 30th Mr Berlusconi suffered another setback, when a judge in Milan ordered him to stand trial once again on charges of corruption. The latest accusations concern a $600,000 bribe he allegedly paid to a British lawyer, David Mills, the estranged husband of Britain's culture minister, Tessa Jowell. Mr Berlusconi and 13 others, including Mr Mills, have already been indicted in a related case that is due to come to court later this month. But many Italians accept his protests that he is being victimised by left-wing prosecutors; there is little sign that these two trials will do him any more damage than his previous ones.

His real problem is age. Although he looks younger, partly because of a hair transplant and cosmetic surgery, Mr Berlusconi is now 70. By the scheduled date of the next election, he will be 74. Even in Italy, which has a tradition of geriatric leadership, the thought of the opposition putting up a man who would be 79 by the end of his tenure is daunting. Both of Mr Berlusconi's senior lieutenants, Gianfranco Fini of the National Alliance and Pier Ferdinando Casini of the Union of Christian Democrats, have said as much in recent weeks. If, however, the government can be unseated soon, Italy's richest man could once again become prime minister.

Hence his haste, evident again this week in a decision to call for a demonstration against the budget in Rome on December 2nd. Mr Berlusconi can expect a big turnout. The draft budget drawn up by the finance minister, Tommaso Padoa-Schioppa, is being modified in response to lobbying by different parties in the coalition. But it is still clear that the Italian middle classes will be hit as never before.

For his part Mr Prodi, who first lost power in 1998 after hard-line Communists had refused to back his government's public-finance policy, is clearly determined not to let it happen again. This week brought another disguised, redistributive tax: a rise in the cost of licence plates for higher-powered cars. This sort of thing is hard for the more centrist elements in Mr Prodi's coalition to swallow. What makes it even harder is the absence of any real attempt to curb the state's notoriously unmanageable spending.

The fragile unity achieved at last weekend's meeting was the product of an undertaking to moderates that, in return for supporting the budget, they would get a pension reform early in the new year. Spending on pensions accounts for almost 15% of GDP. The need for further reform is obvious. Yet the deal, if such it was, was immediately disowned by the two Communist parties in the coalition, on the ground that it was not in the coalition's electoral programme. Their resistance may presage the next big clash within the centre-left—and perhaps Mr Berlusconi's next big opportunity to wrest back power. This one could, however, be his last.

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French riots

One year on

Nov 2nd 2006 | PARIS
From The Economist print edition

A grim anniversary, though with relatively little violence

IT WAS not, the government kept insisting, an anniversary. Yet, exactly a year after rioting broke out in France's troubled *banlieues*, the tension of expectations was almost unbearable. In the event, there was no repeat of last year's widespread copycat violence and car-burnings, which lasted for 20 nights. Instead, there was a series of sinister ambushes, many of them on public transport.

AFP

There'll be another one along in a minute

A year ago some 10,000 vehicles were torched and 233 public buildings set alight in the *banlieues* across the country. Some 3,200 people were arrested, including many teenagers; 785 were jailed. This time the government put riot police on alert, and urged reporters not to broadcast nightly accounts of car-burnings for fear of provoking even more. During a weekend the government called “rather calm”, some 250 vehicles were burnt.

But over the past week there have been a dozen arson attacks on buses, most of them ambushes by gangs. During one such assault in Marseille, a group of teenagers held up a bus and hurled Molotov cocktails into it while the passengers were still on board. One 26-year-old female student suffered 70% burns and was described by doctors this week as being “between life and death”.

As the police arrested five teenagers who were suspected of carrying out the Marseille attack, some broader questions are being asked in France about how much things have changed in the areas one year later. In an interview that he gave to *Le Figaro* this week, President Jacques Chirac said that his government's response had been twofold: “the fundamental fight for equal opportunities” and “firmness in the face of violence”.

In the first area, there has been some effort at improvement. The centre-right government of Dominique de Villepin has accelerated a renovation programme for tower blocks, which covers 600 of the worst *banlieues*. It has expanded a subsidised-jobs scheme, which has helped to bring overall unemployment down to 8.8%, though it remains closer to 50% in some of the worst *banlieues*. There have also been attempts to stamp out discrimination, through a new anti-discrimination body, and to recruit more ethnic minorities to prominent jobs. Political parties are carefully placing black and brown faces on their electoral lists for next year's parliamentary election.

Far harder, however, has been the task of getting to grips with violent crime in the *banlieues*. Whereas

rates of theft and vandalism have been falling, violent assaults on individuals have risen. In the 12 months to September there were over 425,000 such attacks across France, a 6% increase over the same period a year earlier. The ambushes on public transport in the *banlieues* are a new phenomenon. Mr de Villepin said this week that he would stiffen the law so as to punish those who are “involved in and encourage” such attacks, not only those who perpetrate them.

Criminologists say that these ambushes share a common feature with some of last year's riots, in which schools, post offices and gyms were torched: they are all assaults on symbols of the state. Some suggest that this is a self-destructive expression of defiance of authority and the French state. Others say it is an organised attempt by criminal gangs to flex their muscles and face down the police.

Certainly, Nicolas Sarkozy, the interior minister and leading centre-right presidential candidate for the 2007 election, has been tightening up on policing with, for instance, special police raids on criminal gangs. More controversially, he is blaming judges for letting off lightly those whom the police send to the courts. He is also planning to make it easier to prosecute and punish minors.

With only six months to go before the presidential election, crime looks likely to feature prominently once again. This week François Hollande, the Socialists' leader, accused Mr Sarkozy of making matters worse by dismantling neighbourhood policing, thus breaking the link between the police and the community. Mr Sarkozy himself knows that, if he does not take a tough approach, there is a candidate lurking on the far right who is eager to benefit: Jean-Marie Le Pen.

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The European Commission

Musical chairs

Nov 2nd 2006 | BRUSSELS
From The Economist print edition

A European Union of 27 gets harder to run

HOW many politicians does it take to draw up a European law? This is not a Brussels joke, but a tricky question in an ever-expanding European Union. This week the European Commission president, José Manuel Barroso, presented the latest candidate for his team. Leonard Orban, who was in charge of Romania's accession negotiations, will become a commissioner. He will join Meglena Kuneva, Bulgaria's Europe minister, who will become Bulgaria's commissioner when the two countries formally join in January.

The road to the Berlaymont, the commission's vast headquarters, was not straightforward for Romania. Varujan Vosganian, the first choice, was dropped amid allegations that he once collaborated with the secret police. But the real problem is that the addition of Mr Orban and Ms Kuneva will take the tally of commissioners to 27. With one commissioner per country, the number keeps rising; but the number of serious jobs does not. Mr Barroso is having to slice off parts of other commissioners' portfolios. Ms Kuneva gets consumer protection. Mr Orban is to have a new post, in charge of “multilingualism”.

He seems qualified, since he speaks English, French and Italian. But being in charge of translation and publishing is hardly a politically important job that justifies a commissioner's €220,000 ($280,000) salary, not to mention perks and office costs. After the previous enlargement there was talk of splitting the large internal-market portfolio, but this was resisted on efficiency grounds.

Sharing out jobs in Brussels may soon get even harder. In theory the 2001 Treaty of Nice provides that, after 27 countries have joined the EU, the number of commissioners must fall below one per country. The ill-fated constitution proposed to limit the number of commissioners to two-thirds of the number of countries, with a rotation system to ensure that all countries took turns to have a commissioner. But with the constitution in the deep freeze and enthusiasm for the European project waning, it is hard to see any country now gracefully giving up its seat at the European Commission's table.

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Charlemagne

Mediterranean rivals

Nov 2nd 2006
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Spain, long one of Europe's also-rans, is about to join the big league; Italy is going in the other direction

BOTH have centre-left coalition governments. Both are committed to European integration. Both are firm supporters of the draft European Union constitution. Both have low fertility, high immigration and declining competitiveness. And both are Latin, Mediterranean and used to taking siestas.

But now Spain and Italy are converging in a new way. For much of the past decade Spain's economy has been growing at around twice the EU average. At this rate, officials beam, Spain will surpass Italy in terms of GDP per head by 2009. If you account for the black economy (Italy does, Spain does not), Spaniards might be richer already. Yes, such claims should be treated with scepticism: in the mid-1980s, Italy boasted loudly and prematurely of overtaking Britain. But Spain's economy is already as big as Canada's (which is, like Italy, a G8 member). And if you add in demographic trends—an immigration boom is more than offsetting a shrinking native population—then the prime minister, José Luis Rodríguez Zapatero, is surely right to assert that Spain will soon join Britain, France, Germany and Italy in the club of Europe's big five countries.

Spain's new prosperity is the product of long preparation. Compared with other big European countries, Spain has a less generous welfare state. Unlike Italy, it has marginalised its Communist party, which has no base in the trade unions. Trade unions are moderate: they have accepted flexible short-term labour contracts, which French unions resist fiercely. But when compared with Italy, two features stand out. One is the Spanish preference for single-coloured, enduring governments, despite a proportional voting system that favours regional parties. The second is a deep-seated respect for fiscal orthodoxy. Budget discipline was built into the post-Franco settlement of 1976. And the Socialist Party abandoned Marxism and adopted a “third way” as long ago as 1980—years before Tony Blair.

The two features are closely related. Spain tends to have longer-lived, solid governments; Italy has shaky coalitions. Between them Italy's two biggest centre-left parties took some 30% of the vote in April's election and needed nine other parties to secure a majority. Spain's Socialists got over 40% of the vote and fell just a dozen votes short of a majority on their own. The Socialists can play minor parties, mostly regional ones which (a) share the state religion of good housekeeping and (b) want more regional power, off against each other. If it needs to, the ruling party can drum up regional support by offering devolution that does not compromise fiscal austerity.

The contrast is especially sharp right at this moment. Both Spain and Italy are in the process of pushing their annual budgets through parliament. But in Spain, says Francisco Fernández Marugán, the Socialist deputy whose job it is to shepherd the budget through the lower house, the coalition partners will add no more than €500m ($625m) to a budget of around €300 billion. In Italy the government agreed a spending plan unanimously at cabinet level. But when it went to parliament, there were 7,000 amendments, of which no fewer than 3,000 came from the ruling coalition. In Italy party and budget discipline alike seem unknown. In Spain they reinforce each other.

Of course, not everything is rosy in the garden of Spain. The fiscal situation is worse than it looks because two-thirds of public debt, attributable to regional governments, is not accounted for. Compared with Italy, Spain has few internationally competitive small firms. It is overly dependent on construction and is “enjoying” a housing boom. As a result, says José Luis Feito, at the employers' federation, the economy is highly vulnerable to higher interest rates, which are likely to be on their way.

Like Italy, Spain is stuck with high-cost, low-productivity businesses that are vulnerable to Chinese competition; poor schools; and low spending on research and development. Moreover, the political deal by which regional parties support economic stability may be limited. Spain has the most devolved political system in Europe outside Belgium; at some point the Madrid government, especially the finance ministry, will conclude that it has gone far enough (and is costing enough).

From disaster to top table

Overall, however, economic success has produced a change in the public temperament of a country comparable only with that of Germany after the second world war, says Pedro Schwartz, a professor at the San Pablo CEU University in Madrid. For most of the 20th century, after defeat in the Spanish-American war of 1898 (known in Spain as “the disaster”), everybody's favourite topic was “the problem of Spain”. Italy was the model of a modernising Mediterranean state. “Spain is different”, as a tourist slogan of the 1960s used to put it.

Now Spain has self-confidence on steroids. Spanish companies are on acquisition sprees, first in Latin America, now in Europe. Two of Europe's top ten business schools are in Spain; Zara, one of the world's fastest-growing retailers, is based in Galicia. Spaniards no longer feel different; they want to be European. They showed it by being the first to vote for, and overwhelmingly approve, the EU constitution.

This new self-confidence will have consequences both for Spain and for its neighbours. For itself, because confidence makes it easier to sustain economic growth and stability: people sense that it works. For the neighbours, because Spain has long been regarded as an effective but marginal EU member—effective at defending subsidies, but only a medium-ranking power, on a par with Poland or the Netherlands. Its emergence as an equal to Italy and even France will give it a seat at the top table. If there is ever a core Europe or a pioneer group, Spain will be in it.

Its success was partly driven by EU cash, partly by Spain's determination to live up to European standards. But now that success will itself change political weights within the union.

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Interest rates

Tethering inflation

Nov 2nd 2006
From The Economist print edition

The cost of money must go up to contain expectations of higher prices

IN EARLY August the Bank of England caught the City napping when it increased the base rate to 4.75% after a year at 4.5%. On November 9th the surprise will be if the bank's monetary-policy committee does not push the rate up by another quarter-point, to 5%.

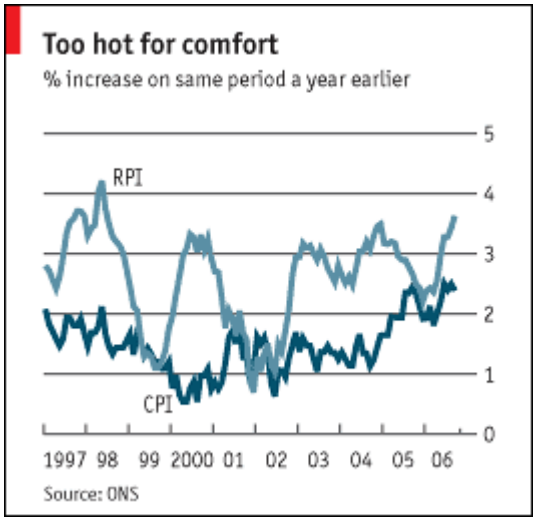
The need for further tightening was set out in the bank's quarterly *Inflation Report*, published shortly after the August rate increase. It takes about two years for changes in monetary policy to exert their full effect on inflation. The forecast showed that keeping the base rate at 4.75% would not be enough to get the annual rate of consumer-price inflation back to the government's 2% target by mid-2008.

Economic developments over the past three months have not shaken the case for a further rate rise. The economy grew by 0.7% in the third quarter, leaving GDP 2.8% higher than in the same period in 2005. More important, inflation remains stubbornly above the target. Despite the recent fall in oil prices, annual consumer-price inflation has eased only marginally, from 2.5% in August to 2.4% in September. Measured by the broader retail-price index, which still features in many pay negotiations, inflation picked up from 3.4% to 3.6%, the highest for over eight years (see chart).

When the monetary-policy committee met in October, it left rates unchanged. The record of its meeting, however, strengthened the City's belief that the bank would act in November. Two of the committee's nine members voted to raise the base rate to 5%. Another group backed an increase but not that month, when a hike would again have surprised the markets and caused an unwelcome jolt in interest-rate expectations.

No such risk attaches to a rise in November, which the markets are still predicting despite a caution this week from Mervyn King, the bank's governor, that the decision was not a “done deal”. Monetary tightening is expected to intensify for two reasons, one familiar, the other less so.

The familiar reason is the housing market. In 2005 residential sales wilted and prices went nowhere. But the market has sprung back into life. House prices rose by 8% in the year to October, according to the Nationwide building society. New mortgage approvals for buying homes were unexpectedly strong in September, rising from 120,000 in August to 126,000, the highest since February 2004. This week's decision by Abbey, Britain's second-largest mortgage lender, to offer home loans up to five times borrowers' salaries may push prices higher still by helping first-time buyers. No such aid is needed at the top end of the London market, which is frothing over as the wealthy compete for prime locations (see article).



The Bank of England has tended to play down the role of the housing market in underpinning the strength of private consumption in the past few years. But people feel richer when they think their homes are worth more. It is hard to believe that a stumbling property market did not play a big part in the abrupt slowdown in consumer-spending growth from 3.5% in 2004 to 1.4% last year, the most sluggish since 1992. The subsequent revival in the market is likely to encourage a stronger than expected recovery in consumption.

For some time the bank has wanted the economy to become less reliant on spending by consumers and the government—the twin engines of growth for most of the past decade—and to get more thrust from investment and exports. After a long period of surprisingly weak growth, business investment is at last picking up. Firms are also being helped by demand from the reviving euro area, which buys about half of British exports. The American slowdown may be less helpful for exporters. All the same, resurgent consumer spending could still pep up overall demand too much.

The threat of excessive demand is at least a familiar one that can readily be countered by dearer money. The bank's rate-setters are operating in more unfamiliar territory in working out what the supply side of the economy can deliver. Their broad aim is to ensure that total demand does not outstrip capacity, since this will push up inflation. But measuring potential output is becoming harder as the economy becomes more open.

As Charles Bean, the bank's chief economist, spelt out in a recent speech, the domestic shackles on business are loosening. Companies facing bottlenecks at home can outsource production to foreign suppliers. Most strikingly, Britain's increasing openness to migrant workers is allowing firms to escape the limits of local labour.

Just how big an impact higher immigration is having on potential output goes to the heart of the rate-setters' dilemma. On the face of it, there has been a spectacular expansion in the workforce since 2004. Around half a million migrants from eastern Europe have started working in Britain over the past two years. Thanks also to the return of older people to work, the labour force has been growing at its fastest rate for more than 20 years.

This suggests that the bank should be pushing up its estimate of potential output. The migration figures are notoriously poor and difficult to interpret, however. For example, some of the newcomers from eastern Europe have returned home, yet timely estimates of this outflow are not available. The sudden increase in the number of workers may also cause a dip in productivity growth that reduces the migrants' boost to the economy. And the big rise in oil prices over the past three years is in any case likely to clip potential output by making some energy-intensive equipment too expensive to use.

In these unusually murky conditions the bank has started to worry more overtly about the rapid growth of the money supply, which increased on a broad measure (M4) by 14.5% in the year to September—the fastest rate since 1990. More importantly, the bank is determined to stabilise inflationary expectations by showing its resolve to hit the 2% target. An increase in the base rate on November 9th would send the clearest of signals to price-setters and wage-bargainers that although inflation may be uncomfortably high now, it will not escape the bank's clutches.

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London property

Gazumped

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From The Economist print edition

Buyers squabble for properties as London's housing market heats up

IMAGINE this page of *The Economist* lying face up on the polished walnut floor of a sumptuous furnished house near London's Dorchester Hotel, in Mayfair. The 84 square inches it would cover is worth just under £1,200 ($2,280). The asking price of this recently renovated Georgian house, with its seven bedrooms, ornate reception rooms and indoor swimming pool, is £16m.

The house is at the top end of London's rapidly rising property market but it is not unique. Farther out from the centre, even a quite ordinary three-bedroom home in Fulham, for example, is likely to cost around £750,000.

House prices in the capital increased by 4% in 2004, by 7% last year and are now rising at an annual rate of almost 9%. They have gone up fastest in the most expensive areas. In Kensington and Chelsea the average price of a flat has risen by 11% a year since 2000 and now stands at £590,000, according to CBRE Hamptons, a property consultancy. A rung up the ladder, demand is growing for homes that cost £10m or more.

British property prices have zoomed upwards for a decade, powered by low interest rates and planning regulations that sharply limit supply. Why they are still rising now that interest rates are heading up is less obvious. But prices in the capital are driven by factors other than the cost of money.

Britain's hospitable tax rules, which exempt foreigners from tax on income earned elsewhere, have lured the super-rich, supporting demand for extravagantly priced properties. “Britain is Monaco for the non-British,” says Paul Davies, whose newest project is converting six flats into a £30m apartment.

Booming business in the City means that properties whose prices are merely exorbitant are selling well too. The Centre for Economics and Business Research, a consultancy, estimates that investment bankers and fund managers will collect almost £9 billion in bonuses this year. “Now that bonuses are on their way, people are putting in their orders for Porsches and looking for houses where they can park them,” says Nick Jopling of CBRE Hamptons. He reckons there are about nine buyers for every home coming on to the market.

With sellers firmly in the ascendant, some of the worst tricks of the late 1980s—when London house prices were rising by as much as 26% a year—are back in vogue. Sellers are once again “gazumping” buyers with whom they have agreed a deal in favour of a better one. Even more common are mini-tenders, in which a clutch of interested buyers make sealed offers for a property. These now take place in almost half of all sales, up from about one in ten a year ago, says Marc Goldberg of Hamptons.

Yet residential prices are already high, compared with incomes and rents, and London's upwardly mobile property prices look precarious. PricewaterhouseCoopers, a consultancy, reckons there is a one-in-three chance that British house prices will be lower in 2010 than they are now. When the go-go 1980s gave way to a property bust in 1989, prices did not recover for almost a decade.

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Iraq

Bad timing

Nov 2nd 2006
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The Commons will have an inquiry into the Iraq war, but not yet

BY JUST 25 votes Tony Blair's government managed on October 31st to head off the latest challenge to his policy on Iraq. It defeated an attempt to force an official inquiry into the conduct of the war and its aftermath. Even so, it seems certain that such an inquiry will be held, and sooner rather than later.

The motion was tabled by anti-war Welsh and Scottish nationalists and picked up by other parties. The Liberal Democrats, who opposed the war from the start, were logical supporters. Less so were Conservative MPs, who, a few rebels aside, voted with the government to invade Iraq in 2003. The foreign secretary, Margaret Beckett, who has the manner and bearing of a particularly terrifying headmistress, accused the Tories of opportunism.

AFP

No inquiry until they're back

To hold an inquiry now, she said, would threaten the morale of British troops in southern Iraq and distract the government from its efforts to help the Iraqis achieve a stable democracy. Besides, there had already been four Iraq inquiries of one sort or another: two by Commons select committees (one on the decision to go to war, the other on the intelligence evidence for weapons of mass destruction); the Hutton Report into the death of David Kelly; and the Butler Report, a further investigation into how the intelligence leading up to the war had been handled.

Yet none of these inquiries has had as broad a remit as the one set up under Lord Franks after the Falklands war and conducted by senior privy councillors. There has been no examination of the strategic choices that were open to the prime minister in the run-up to war nor of the decisions, some disastrous, taken over post-war planning both before and after the invasion, in which Britain was at least acquiescent. A wider inquiry might also want to gauge the extent to which the special relationship with America has operated in Britain's national interest.

As for the notion that there could be no inquiry until British troops were safely home and their mission accomplished, that stretches credulity. After all, General Sir Richard Dannatt, the head of the army, thought that he could raise questions about the British presence in Iraq without undermining his troops.

Still more to the point, as William Hague, the shadow foreign secretary pointed out, debates and inquiries have often been held when arguably even more was at stake for the nation than there is in Iraq. In 1855 the Commons voted for an inquiry into the conduct of the Crimean campaign while the war raged; in 1916 a Royal Commission was appointed to investigate the calamitous attack on the Dardanelles; and the debate over the Norway campaign in 1940 led directly to Churchill replacing Chamberlain as prime minister.

The real reason for the government to resist an inquiry now is not because the troops are still in Basra, but because Tony Blair is still in Downing Street and he can do without the distraction during his last seven or eight months in office. Mr Blair himself hinted the day after the debate that an inquiry had not been ruled out forever. It is more than likely that Gordon Brown might find it a useful way to draw a line under his predecessor's most controversial policy.

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Transport

Stuck in a tunnel

Nov 2nd 2006
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A fix for London's clogged transport network is long overdue

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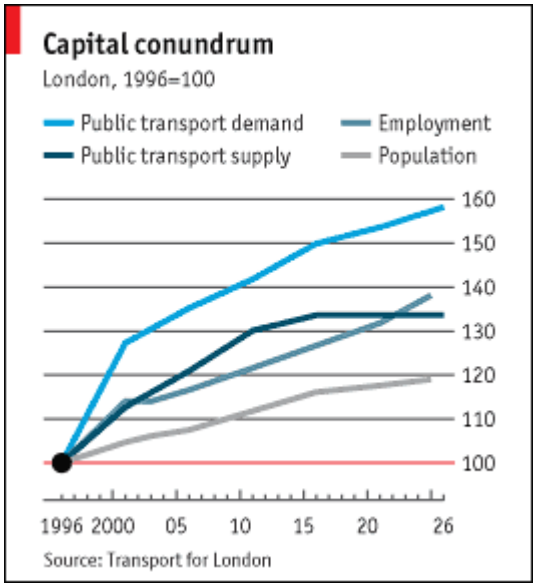

FEW things unite Londoners—a famously argumentative lot—like complaining about their city's overcrowded public transport. Stuffed Tube and train carriages are a sore point for barmen and businessmen alike. Last week, at the 20th anniversary of the financial deregulation that set off two decades of almost continuous economic growth in the capital, a cadre of City bankers told the government that poor transport was one of the biggest impediments to London's future success.

Transport for London (TfL), which runs most of the city's transport routes, reckons that demand for Tube and train services exceeds supply now by about 12%. And the problems are set to get worse. By 2025 another 800,000 people are likely to live in London, TfL forecasts, bringing the total to 8.3m. Almost 1m new jobs will be created, many of them in the city's already-crowded financial districts.

But last month two rare pieces of good news brightened commuters' gloom. The first was that Thameslink—a long-mooted upgrade to an existing north-south railway through the city—had received planning permission. The second was that a contract to extend the East London Tube line had been awarded (to Balfour Beatty, a big engineering firm).

That this—and more—new capacity is necessary seems obvious, at least to Londoners. Bus services have been increased and capacity upgrades are planned for various bits of the Tube. But all this will barely preserve the status quo, says Jay Walder, TfL's finance director. Capacity on the Jubilee line to Canary Wharf, the second financial centre, will rise by 45% by 2009, for example; yet by 2012 he expects the line to be as overcrowded as it is now.

In the face of such pressing need, the main feature of London's plans has been their glacial slowness. The East London line is needed for the Olympic Games in 2012, but other proposals—without such an external deadline—have struggled. The Thameslink scheme was first proposed in 1991, when it was optimistically known as Thameslink 2000. Despite its new planning permission no money is yet available.

The same is true of Crossrail, an ambitious plan to connect (among other things) Heathrow airport to the city's financial districts. It is considered vital: Mr Walder describes it as the only scheme that will make a dent on overcrowding. Yet the plan dates back, in various forms, at least to 1989. “I have a collection of newspaper front pages saying ‘Crossrail gets the go-ahead!’” says Stephen Glaister, a transport expert at London's Imperial College. “I get a new one every few years.”

The latest version of the scheme is trundling slowly through Parliament, which already rejected one proposal in 1994. Even the most ardent optimists doubt that any trains will run before 2015.

Money, says Mr Glaister, is at the heart of the delays. Crossrail is expected to cost roughly £10 billion ($19 billion). When it was first proposed, the benefit-to-cost ratio was too slim to persuade the Treasury. Tony Travers, of the London School of Economics, says London could in theory pay for the scheme itself, but that Britain's overly centralised tax system—which gives town halls almost no freedom to raise

money—prevents it from doing so.

Two big reports due by the end of the year may bring hope to squashed commuters. A report on transport by Sir Rod Eddington is expected to back Crossrail; another, on local-government finance by Sir Michael Lyons, is likely to argue that town halls should be freer to raise money. Whether either will be enough to jump-start London's transport projects remains to be seen. After so many false dawns, Londoners will despair if they don't.

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About sponsorship

Rural post offices

Cheques in the post

Nov 2nd 2006
From The Economist print edition

A day in the death of rural Britain

FEW institutions of state stir passions in the countryside quite as much as the local post office. It is, its champions argue, the heart of the village, the glue that binds the community. Locals gather to gossip beneath its cheery red sign, and on its walls they post important notices regarding parish life. Occasionally they may buy a stamp there, but, alas, in numbers insufficient to support it. Much though it is loved, the village post office is on the way out.

For years the post office was the main point of contact between many citizens and the state. There they could pay their television-licence fees and collect their pensions. But in recent years many of those functions have been moved to cheaper providers or to the internet. In 2003 the government began paying benefits and pensions directly into bank accounts as well as into postal accounts, and this year the BBC stopped selling television licences through post-office branches.

This shift of services has trimmed annual income across the post-office network by more than £400m, according to some estimates. Branches have tried to compensate by becoming more entrepreneurial. Many now offer credit cards, travel insurance and personal loans along with the usual stamps and stationery. But income from these ventures has not increased enough to compensate for the loss of government business. Last year the network lost some £111m.

Faced with falling incomes, many post offices are closing. Fewer than 500 of the country's 14,000 postal outlets are owned directly by Post Office Ltd, which runs the network. The rest belong to sub-postmasters, usually small shopkeepers working on contract for the Post Office. More than a fifth of all branches, both urban and rural, have closed since 1999. As the government estimates that only 4,000 post offices are commercially viable, more closures are bound to come.

The situation facing the country's 8,000 rural post offices is especially dire. Although rural branches make up more than half of the total network, they account for less than one-tenth of Post Office business. Few would still be open were it not for an annual government subsidy of £150m, about £19,000 apiece. But a good deal of this spending seems to benefit a very few people: the smallest 800 branches, says the government, are used by an average of just 16 customers a week.

Even though Britain still has more post offices per head than Germany, Japan or America, closing them is bad for votes. Last month hundreds of umbrella-brandishing postmasters and postmistresses gathered outside 10 Downing Street to present a petition signed by more than 4m people that called on the government to save post offices. With an eye on the rural vote, the Commons trade and industry committee this week urged greater government support for the post-office network.

Almost 400 MPs have also signed an early-day motion asking the government to carry on paying pensions and benefits into the postal accounts held by more than 4m people. The government wants to end this contract in 2010 because each payment through the post office costs it about £1, whereas a transfer into an ordinary bank account costs just 1p. Some unpopular decisions (and angry villagers) are awaiting delivery.

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Oxbridge admissions

The $64,000 question

Nov 2nd 2006
From The Economist print edition

Can private coaching get results that intelligence and hard work cannot?

Get article background

WHAT shape is an egg? Why is the sky blue? Students who have just applied to Oxford and Cambridge for next year are obsessed with such questions. And entrepreneurs who promise to help them find definitive answers for the interviews they hope to have are cashing in. Amid fierce competition (27,800 have applied for an estimated 6,500 Oxbridge places next year), pushy parents and pragmatic secondary schools are shelling out for private coaching.

Oxbridge Applications, an admissions consultancy started by James Uffindell in 1999, is thriving, with turnover last year of £450,000. The company says it helps a tenth of Oxbridge applicants each year, and this assistance does not come cheap. Commissioning a draft application costs £120 and, for those with rather more cash to splash, £850 buys a weekend preparing for the all-important college interview. A new company set up in January, the Oxford Mentoring Scheme, offers applicants year-round support. For £390, students are advised by Oxford graduates and put through mock interviews to practise their technique.

Such private-coaching firms are especially popular among state schools, who want to buy for their students the sort of intensive preparation that independent schools give their own Oxbridge hopefuls. Mr Uffindell says that two-thirds of his clients come from the state sector.

In America, making money out of the college-application process is a long-established business. Kaplan, founded 68 years ago, has helped around 3m students prepare for standardised scholastic-aptitude tests (SATs). Its business is booming now: revenues were $1.4 billion (£770m) in 2005, compared with $89m ten years ago.

But not everyone has embraced this American export. Many at Oxford and Cambridge fear that professional coaches make their universities seem inaccessible. These firms portray the interview process as mysterious and intimidating, and this deters potential applicants from poor and minority backgrounds, says Geoff Parks, director of admissions at Cambridge.

The value of such preparation is questioned too. Oxbridge Applications claims that its clients are twice as likely to be offered places as those who go into their interviews cold, but one Oxford fellow believes coaching is counterproductive. The interview process is designed to get beyond what a candidate has been taught, says Emma Smith, an English tutor at Hertford College.

Proponents of private coaching put such criticism down to Britain's fondness for the gifted amateur and a reluctance to call in professionals in order to maximise your advantages. Demand for private coaching looks set to rise as pressure on places among the dreaming spires intensifies. With applications for entrance to Oxford and Cambridge up by 4.3% this year, more students may decide to cast amateur status to the winds and go for the commercial competitive edge.

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Road safety

Knocked down

Nov 2nd 2006
From The Economist print edition

Official road-casualty figures are flattering to deceive

WHEN the government said in 2000 that it wanted to see a big fall over the coming decade in the number of people killed or seriously injured on the roads, its target seemed reasonable. Road casualties had been in long-term decline since the 1960s and seemed likely to carry on falling. The police figures that policymakers were relying upon showed that road users were indeed becoming less accident-prone.

It now seems likely, however, that these figures have come adrift from reality. In June three public-health experts compared the police numbers with hospital figures, in an article in the *British Medical Journal* (BMJ). They found that hospital staff, unlike the police, have seen little change in the numbers of people injured on the roads (see chart).

Some of the reasons for this strange set of affairs are now becoming clear. On October 31st the transport select committee of the House of Commons published a report on law enforcement on the roads. It expressed particular concern at the replacement of large numbers of traffic police with speed cameras.

One obvious consequence of the switch is that officers are seeing fewer of the accidents that take place. Speed cameras cannot stop the weaving drunks whom a police officer would spot: unsurprisingly, the number of drivers who are breathalysed has dropped. Cameras are not even particularly effective at curbing speeders, for they are constrained by rules that mean they can only be put where there has been a number of serious accidents and must also be highly visible.

Many accidents are caused by people who are driving without licences, or uninsured. They may be especially tempted not to report accidents if the lack of police means they can get away with it. This seems to be an increasing problem—the committee heard evidence that suggests a big rise in hit-and-run accidents.

A more subtle cause for the widening gap between the two sets of figures may be the very fact that a target has been set. Police must try to judge the severity of injuries at the scene of an accident—for example, whether a victim is “severely” or “slightly” shocked. The drive to reduce serious injuries may have led to a drift in officers' interpretations of the word “serious”.

The Department for Transport has known for some time that police figures undercount road casualties. But as long as the level of undercounting remained stable, it seemed reasonable to keep using them to monitor trends. The authors of the BMJ paper are certain, however, that the undercount is getting worse. They point to the fact that road deaths, which are unambiguous and almost always show up in police figures, have fallen much less than police-recorded non-fatal injuries.

John Adams, an expert on risk at University College London, says that road fatalities have gone down over the long term, despite ever-increasing traffic, because people are becoming more risk-averse: they have learnt that roads are dangerous and adapted their behaviour accordingly. In 1971 he surveyed seven- and eight-year-old children, and found that four in five walked to and from school without an adult. Now, he says, you couldn't find a school that would let such young children leave the premises alone.

Mr Adams reckons that the trend in road casualties really depends on the rate at which vulnerable road users adapt to the increasing dangers. It now seems that Britain's roads are getting more perilous at a faster rate than road users are becoming frightened of them. “Stop, look and listen” still matters.

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Bagehot

We're all green now. Up to a point

Nov 2nd 2006
From The Economist print edition

Despite the praise for the Stern review, Gordon Brown will still go slowly on green taxes

Get article background

RARELY can what passes for the British establishment have been so united. The leaders of the three main parties, the serious newspapers (bar one), the BBC and company chairmen greeted Sir Nicholas Stern's report on climate change with such a chorus of gratitude that one might have thought the distinguished economist had single-handedly rescued the planet from certain destruction.

Highly unusually, it is the leader of the opposition who can take some of the credit for this. At the last election, just 18 months ago, environmental issues hardly got a look-in. Indeed, when the Stern review was commissioned by Gordon Brown in July last year, it was not seen primarily in domestic political terms at all. It was intended mainly as a response to the constant carping of George Bush's administration at the G8 summit in Gleneagles that it would not countenance any measures to combat global warming that might weaken the American economy.

But thanks in part to David Cameron's decision to put green issues at the heart of his attempt to redefine the Conservative Party, Stern has acquired a significance for British politics that Mr Brown would almost certainly not have predicted. Publication of the report has effectively fired the starting gun in the race between the parties to prove which has the greenest credentials. Unfortunately, and somewhat unfairly because of the different baggage they carry, it's a race that carries much greater risk for Mr Brown than for Mr Cameron or the Liberal Democrats.

Mr Cameron's greening of the Tories serves a vital purpose for him and his party. When he took over as leader last December, it was clear from research undertaken during and after the 2005 election what the most urgent requirement was. Somehow Mr Cameron had to rebuild support among the professional middle classes and younger voters who had decided the Tories were selfish, illiberal and plain nasty.

Cavorting with huskies on the melting polar ice cap and sticking a wind turbine on his roof may have struck some as cheesy. But his conspicuous greenery appears to have worked as a metaphor for a new Conservative decency that wins Mr Cameron trust on other more immediate issues, such as the health service. The Tories over-claim when they say that Mr Brown has only become serious about climate change since they put it at the top of their political agenda. But the chancellor's interest in the subject

has certainly grown with the threat from Mr Cameron.

Galling though it may be for the Lib Dems to find their green ideas being pinched, they can at least claim that others are following where they have led. They can also point out that they have already come up with a pretty radical package that substitutes “good” green taxes for “bad” taxes on incomes, especially those of the poor. And because nobody expects their high-minded but potentially painful policies to be implemented, the Lib Dems can never be outbid in a “who's the greenest?” competition with the bigger parties.

For Mr Brown and the government he expects soon to lead, the political calculations are less clear-cut. Britain can boast that it is just about the only country on course to meet its Kyoto targets (thanks mainly to the “dash for gas” in the mid-1990s). Tony Blair can also claim to be the first world leader to have made climate change a priority for the G8. But although public attitudes to climate change are changing fast, the chancellor will take some convincing that elite opinion's welcome for Stern is matched by the electorate's appetite for personal sacrifice.

David Miliband, the youthful and ambitious environment secretary who is widely seen as Labour's next-leader-but-one, is pressing Mr Brown to go further and faster with an array of new eco-taxes. One of Mr Miliband's wheezes is to allow the Treasury to ratchet up the cost of petrol by raising fuel duty whenever oil prices fall. When Mr Miliband's list of bright ideas was leaked last weekend, however, the Treasury did not hide its irritation at his presumption. Mr Brown has not forgotten how the so-called fuel-tax escalator, a less-sophisticated forerunner of Mr Miliband's modest proposal, landed the government in its first bout of real unpopularity six years ago, when angry lorry-drivers led an insurrection over the price of diesel.

Although people are happy to tell opinion pollsters how gung-ho they are for green taxes, they may feel differently when the increased costs of keeping a car, taking a holiday or disposing of the rubbish start to bite. The reaction of popular newspapers to Stern was almost as hostile as that of their upmarket counterparts was gushing. The *Sun* summarised the prime minister's aims with the headline: “I'm saving the world...YOU lot are paying.” The *Daily Mail* trundled out one of its big-gun commentators to denounce the scientific basis for Stern as “Phooey”. The one statistic they relentlessly reminded their readers of was that Britain accounts for a mere 2% of the world's carbon emissions, while China adds the same amount to its emissions every year.

Stealthily does it

There is another reason for Mr Brown to err on the side of caution. After exhausting every conceivable way of extracting money from British taxpayers without reneging on his promise to leave the upper rate of income tax unchanged, the chancellor knows only too well that he is stuck with a reputation for taxing by stealth. The Tories may just about be believed when they say that the new green taxes they support will be offset with reductions elsewhere. Mr Brown is unlikely to enjoy the same benefit of the doubt.

Mr Brown, we can assume, is no less keen on saving the planet than Mr Cameron. But it will not be entirely surprising if he thinks the answers to global warming lie more in complex international carbon cap-and-trade agreements than in daringly trail-blazing tax experiments at home.

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Climate change

It may be hot in Washington too

Nov 2nd 2006
From The Economist print edition

AP

A big British report on global warming is really directed at the United States

Get article background

RARELY has a report with so many charts and equations in it caused such a stir. Sir Nicholas Stern's review of the economics of climate change, published on October 30th, was all over the local media and much of the foreign press too. But the figures splattered over the report's 600 pages were something of a red herring, for the report was more about politics than about economics—specifically, the politics of getting America involved in the global effort to mitigate climate change.

Gordon Brown, Britain's finance minister, commissioned this review after the Gleneagles G8 summit in 2005. The government had set Africa and climate change as the main items on the agenda for the big powers. The participants got a long way on Africa and nowhere on climate change.

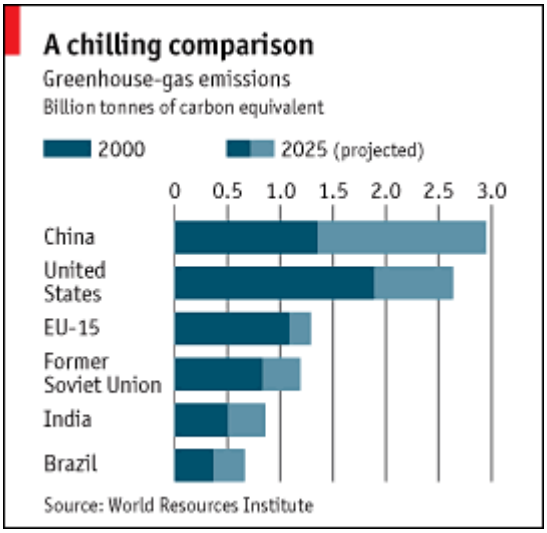
One reason for that was America's reluctance. It was a moving force in the effort to curb greenhouse-gas emissions in the 1990s, when the Kyoto protocol was being negotiated, but in 2001 the Bush administration refused to ratify Kyoto and has since shown no interest in the matter. Europe, Japan, and a very half-hearted Canada are doing their bit; but American involvement is generally reckoned to be crucial, not just because it is the world's largest emitter of greenhouse gases (see chart) but also because unless America tries to curb its emissions, developing countries won't either. And American intransigence has been particularly irritating to Tony Blair, because climate change is one of the areas where the British prime minister might have got some reward for his support over Iraq.

Sir Nicholas, who says he had no views on climate change before taking the job, has come up with a report that looks perfectly designed to push America's buttons. Most previous assessments of the cost of climate change to the world economy are relatively modest—in the order of 0-3% of global output. Since the costs of stabilising carbon dioxide concentrations by switching to alternative fuels are, most economists reckon, around 1% of global output by 2050, it might be worth doing something about climate change even on the basis of those figures.

But rich countries tend to do relatively well from those forecasts. Some—especially those in northern Europe—actually benefit from a bit of warming. The brunt of the costs falls on poor countries, because they are hotter and relatively dependent on agriculture. Rich countries just about manage to

Infographics

put up with the sufferings of poor countries now. A bit more is unlikely to move them to curb their emissions.



Sir Nicholas, however, comes up with quite different figures. By feeding into his model both some recent science on the increased risks of dramatic climate change, and the possibility of such catastrophes as a rise in sea level big enough to flood London and New York, he calculates that the range of possible outcomes lies somewhere between 5% and 20% of global output over the next century or two. At those sorts of levels of overall economic damage, the impact on the rich world as well as the poor world is huge.

Sir Nicholas's policy prescriptions, as well as his analysis, seem designed to draw America in. Although most economists argue that a carbon tax would be the most efficient solution, Sir Nicholas is neutral between a carbon tax and the other ways of raising the cost of emitting carbon—by regulation or a cap-and-trade system. Those are the methods America has tended to use to control pollution. Vehicle emissions, for instance, are controlled by regulation in America, whereas they are mostly discouraged by fuel taxes in Europe. Sulphur dioxide pollution in America has been cut by a successful cap-and-trade system. Europe adopted a cap-and-trade system to cut its emissions under Kyoto only because America was plugging the idea before it pulled out. America's aversion to taxes means that a carbon tax is not regarded as a serious option.

While resisting pressure to curb carbon emissions, the Bush administration has enthusiastically subsidised alternative energy technologies such as biofuels and nuclear. Many economists doubt the value of picking winners in this way. But Sir Nicholas supports the idea of technology subsidies as a vital part of the policy mix. Even if governments manage to put a global price on carbon, he says, the private sector will not necessarily trust them to maintain it, so may need extra incentives to invest.

It may be a good time to give climate change an extra push in America. A campaign by Al Gore, a former vice-president, has given the issue momentum, as has California's adoption of Kyoto-style targets. California is now talking about setting up a European-style emissions-trading scheme with north-eastern states.

A lot of businesses, convinced that the federal government will somehow raise the price of using fossil fuels, are investing in developing green technologies because they believe that the market for them is bound to grow. The more the private sector invests in greenery, the less resistance there is to legislation.

The Bush administration is sticking to its position that investing in new technologies, not controlling emissions, is the way to go. But there are a number of bills hanging around Congress, at various stages of maturity, to control greenhouse-gas emissions. One of them is backed by John McCain, the Republican front-runner for the White House in 2008. If he, or Hillary Clinton, the Democratic front-runner, get the job, America may well once more take a lead in the global effort to mitigate climate change. Which is what Sir Nicholas's report is all about.

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Deforestation

Stop stop the chop chop

Nov 2nd 2006 | SÃO PAULO
From The Economist print edition

Trees and how to save them

Get article background

FEW things on earth seem as defenceless as a forest. To many people, it is worthless unless harvested for its trees or destroyed to create farmland. Tropical forest is vanishing at a rate of 5% a decade, wrecking habitats and releasing 3 billion tonnes of carbon dioxide a year, a fifth of global greenhouse emissions.

Most tropical forest is in poor countries, so giving it monetary value may be the best way to save it. Efforts to do that are accelerating. At a United Nations meeting on climate change in Kenya next week, Brazil is expected to propose a fund to reward developing countries that cut their rate of deforestation. This is a change of heart: till last year, Brazil had resisted the idea of taking cash in return for keeping trees intact.

Brazil's idea relies on contributors' goodwill. The only penalty for countries that cheat would be the loss of future incentives. Some think it might be better to trade certificates in “avoided deforestation” in the global carbon-credit market, through which polluters in rich countries can pay others to reduce emissions.

The economic value of chopping down trees varies widely, the World Bank notes in a new study*. Pasture in the Amazon is worth as little as $200 a hectare. At the current price of carbon credits (which is volatile) the same area of dense rainforest would be worth around $7,500, says Kenneth Chomitz, the report's main author. So the gains from clearance are often much less than the cost to the planet of the carbon released by burning or rotting trees. Thus it may make sense for rich polluters to pay, via the market, for the forests' upkeep.

Sceptics say “dumping” forests on the world's carbon market would lower the price, thus reducing the incentive for rich countries to use greener power—unless emission targets were toughened, which would tighten the market. Other greens say countries should be paid for providing “eco-services”—like biodiversity—and not just for avoiding destruction.

But even if the effect of “cash for non-deforestation” is short-term, it is worth having: it could buy time to develop non-fossil fuels.

In any case, Brazil is already making progress. Deforestation in the year to August dropped 30% to 13,000 square kilometres (5,000 square miles). Last year's fall was similar. One (changeable) factor is a strong currency, which depresses prices for farm products. IPAM, a think-tank, also credits tougher state action against land grabbing and corruption.

All this will boost Brazil's case as it sets out to convince other countries it can reliably deliver exactly what they say they need—intact forests.

*“At Loggerheads? Agricultural Expansion, Poverty Reduction, and Environment in the Tropical Forests”

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Mercenaries

Blood and treasure

Nov 2nd 2006
From The Economist print edition

After the windfall of Iraq, where is the next fortune to be found?

MERCENARIES have been part of history since the dawn of warfare, from Xenophon's “ten thousand” Greeks hired to fight in Persia to the Swiss Guards who protect the Vatican today. Indeed, the word “soldier” derives from *solidus*, the Roman gold coin; in other words, a soldier was one who fought for money.

In recent decades, mercenaries have been pushed to the wilder edges of global conflict: the “dogs of war” who fight nasty little campaigns in Africa. But for a new kind of soldier of fortune, the fighting in Iraq has proved to be a pot of gold. Private security companies' hired guns have grown into the second largest military contingent in Iraq, after America's forces.

Estimates of their number range from 10,000 to 30,000. They build and supply military camps, guard places such as Baghdad's “Green Zone”, protect convoys, gather information and provide bodyguards for officials, businessmen, aid workers and journalists. The cannier ones have become millionaires.

Now they say the gold rush may be ending. Reconstruction projects are running down, and with them the contracts to protect the contractors. The market is saturated, meaning lower prices. It is uncertain how long America will remain in Iraq, and how much business the Iraqi government will transfer to local outfits.

At a conference of security firms in London this week, well-muscled ex-soldiers who have swapped their fatigues for pinstriped suits fretted about the future. Pickings in Afghanistan are thin; there seems little chance of America starting another big war, with the juicy contracts it brings.

They forecast consolidation: big firms buying little ones, and more transatlantic tie-ups. American firms depend heavily on Pentagon contracts, British ones specialise in risk consultancy and security services for private business, particularly oil and mining companies.

The industry by some estimates turns over $100 billion a year, though the definitions are contentious: what counts as a military company, and what is merely an engineering firm building barracks? Less contentious is the need to diversify. The most lucrative business is not “guns on trucks” but logistics and other less glamorous jobs, such as maintaining weapons systems. Swaggering men with wrap-around dark glasses may catch the headlines—particularly when they are accused of shooting Iraqi civilians—but the real money is elsewhere.

The Pentagon has led the way in privatising jobs once done by regular soldiers. The logistics provided by Brown & Root (now part of KBR), a subsidiary of Halliburton, were central to the American deployment in the Balkans in the 1990s. Halliburton's chief executive at the time (now Vice-President) Dick Cheney said: “The first person to greet our soldiers as they arrive in the Balkans and the last one to wave goodbye is one of our employees.” America has also used private firms to give military training for foreign armies. The nebulous aid provided by one firm, Military Professional Resources Inc. (MPRI) to Croatia is widely linked with that country's success in the final phase of Bosnia's war.

Using private contractors not only allows governments to conduct politically sensitive operations at arm's length, but also cuts the political cost of direct military operations: dead contractors mean fewer protests than dead soldiers. Military casualties in Iraq are carefully recorded, but there are no firm figures for security contractors, though hundreds have died.

This year's Quadrennial Defence Review treats private contractors as an integral part of the “total force”

at America's disposal. But contractors have drawbacks. They are accused of profiteering, poaching experienced soldiers from regular military units and of being less accountable than soldiers. Private contractors were involved in the torture scandal at the Abu Ghraib prison in Iraq, but only the military interrogators have been prosecuted.

Seeking new lines of business, security companies are looking at protecting events, such as the Olympics, bringing aid to places where humanitarian workers fear to go and providing services and expertise for the United Nations.

Security companies have already dabbled in these areas, but any real breakthrough will require them to clean up their reputations more convincingly. “People always ask me about mercenaries and the dogs of war. I tell them we are actually the pussycats of peace,” says Andrew Bearpark, director-general of Britain's industry association, the British Association of Private Security Companies. (America's equivalent has an even cosier name—the International Peace Operations Association.)

Security firms say they want firm government regulation; in that they agree with their critics. But while some see legislation as the means of restraining “corporate mercenaries”, many of the security companies see it as a badge of respectability that will open up lucrative corporate, government and international contracts.

The firms face a dilemma: they may want to dispel any notion that they are mercenaries, but they also trade on the warrior mystique. After all, who would use a pussycat as a guard-dog?

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Muslims and security

The price of freedom

Nov 2nd 2006
From The Economist print edition

A fine line between vigilance and witch-hunting

“PEOPLE can lose clearance on the vaguest excuse, without being told why—it's a new McCarthyist mood.” That's one reaction (from a London human-rights lawyer, Louise Christian) to reports from several Western countries that Muslims are being laid off from sensitive jobs—as customs officers, for example—on security grounds.

At the other extreme, there is no shortage of voices making the opposite argument: that security services are too slow to see the threat from “sleepers” whose job puts them in a position to wreak havoc. “The scandal is that suspicious people were hired in the first place,” says Mark Baillie, a terrorism wonk at International Policy Network, a London think-tank.

In an ever more polarised climate, almost any report on this subject can trigger opposing reactions. In Britain, it emerged this week that the son of Abu Hamza, a jailed Islamist preacher, had been doing maintenance on the London underground—before his employers found he had been convicted in Yemen over a bomb plot. The story enraged the tabloid press. But initially Ken Livingstone, London's leftist mayor, said it was fine for Mohammed Kamel Mostafa to work on the Tube—only to back down later, saying the young man had hidden his past.

Similar emotions have been triggered by French efforts to crack down on Islamism at Charles de Gaulle airport, outside Paris. Last month alone, Nicolas Sarkozy, the interior minister, decided to withdraw accreditation from 43 Muslim employees at the airport. Several baggage-handlers have taken their case to a court, claiming discrimination against Islam.

Mr Sarkozy's worry about the airport is not new: in April he said he was probing 122 employees who worked inside the airport's security zone, and that 60% would have their authorisation repealed or not renewed. In the summer, police shut down several secret prayer rooms at the airport.

In North America, Islamic groups say cases of “religious profiling”—denying Muslims the right to cross borders, board planes or take certain jobs—have grown faster in recent months than they did after September 11th. And arguments over security and liberty are likely to get louder as the range of “sensitive” jobs grows longer. As Mr Baillie says, “a programmer working in air-traffic control or a power plant can do more damage than an old-time spy.”

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Retailing

Setting up shop in India

Nov 2nd 2006 | DELHI
From The Economist print edition

Metro

Foreign retailers mount an onslaught on India, and local companies fight back

Get article background

INDIA's retail revolution is at last getting started. At the moment 97% of retail sales are made in more than 15m tiny mom-and-pop stores, mostly of less than 500 square feet (46 square metres). But now Reliance Industries, the country's largest business group, is to spend 250 billion rupees ($5.5 billion) on big new shops over five years, starting on November 3rd when it will open 11 convenience stores in the southern city of Hyderabad. And big foreign companies are moving in too. The government bans them from selling direct to individuals, but they have found a side door: starting wholesale and sourcing companies which supply a local retail partner. The first to do this, last month, was Australia's Woolworths, in league with Tata, India's second-largest firm. Tesco, from Britain, is expected to follow soon, and Wal-Mart and France's Carrefour are also thought to be searching for a way in.

Reliance rarely develops its new ventures quietly, so rumours and leaks about its plans have sparked a chain reaction. Foreign firms have realised that they need to get a toe-hold in India quickly, without waiting for the government to open up retailing to foreign direct investment (FDI) properly. If they wait too long, they risk leaving the field clear for big Indian groups, such as Pantaloon Retail and Spencer's, which have been accelerating their expansion plans and securing scarce development sites.

For overseas companies looking for growth outside sluggish domestic markets, India's retail business is one of the most attractive. Consumer demand is booming as the government's steps to liberalise the economy have produced GDP growth of around 8-9% a year. Technopak, a Delhi-based retail consultancy, expects retail sales of $250-300 billion now to rise to nearly $430 billion by 2010. Modern retailers' share will rise from just 3% now to 16-18%, it says.

Retailing is one of the last big sectors of the Indian economy to open up to FDI. Previous attempts by foreign retailers to start businesses were blocked by successive governments. In the 1990s opposition from traders and local shopkeepers was enough to convince politicians. Later on the government was persuaded by the political left, and also by the Indian business lobby. The current government now has no hope of allowing FDI into general retailing by the end of this year. But side-door entries are permissible. “We need a model that doesn't replace existing retailers,” says Kamal Nath, India's minister of commerce and industry.

Under the current policy, Western brands from Reebok and Cartier to Marks & Spencer have set up franchise stores with locals. The locals own and run the shops, and the foreigners run the sourcing and wholesale part. Starbucks, a coffee-shop chain, is expected to open soon as a similar franchise. Earlier this year the franchise policy was relaxed, so that foreign firms can now take 51% equity stakes in shops that sell just their own brand. But this has yet to catch on in practice. Broader wholesale businesses selling to registered retailers have also been allowed, though Metro of Germany is the only company to have used this route so far.

The newest model for foreigners getting into India is the Infiniti-Woolworths partnership. Infiniti Retail, a Tata group company, last month began opening “Croma” stores that sell electronics and household electrical goods sourced from a wholesale company in India fully owned by Woolworths. “I pay a cheque every Wednesday for the previous week's supplies,” says Ajit Joshi, managing director of Infiniti, explaining the relationship. Bharti Enterprises has been discussing a similar deal with Tesco and most recently with Wal-Mart. “Government policy allows foreign equity in back-end wholesale and logistics and in real estate, so we'll do a joint venture with a foreign partner in those areas, and we will own the retail business 100% till the government allows FDI there, and then we'll do a joint venture there with our partner,” says Sunil Mittal, Bharti's chairman. He will not confirm whether the retail partner will be Tesco or Wal-Mart, but says he hopes to sign a deal by the end of November.

Reliance intends to have 5,000 shops across India within five years. There will be 2,000-5,000-square-foot convenience-food stores of the sort now being opened in Hyderabad, and also bigger, 25,000-50,000-square-foot hypermarkets, starting with one in Ahmedabad at the end of the year. Pantaloon Retail, India's biggest and fastest-growing retailer, has 144 shops in 32 cities, and Kishore Biyani, its founder, plans to double the square footage of his empire by next June. Local businessmen have started smaller chains in the south.

India's millions of small stores, of course, are terrified of the onslaught from domestic and foreign retailers. Many Indians may stick to the small, personal shops they are used to. But the modern emporia will offer lower prices and, presumably, higher quality. “Shopkeepers are asking, ‘is Reliance going to kill us?'” says Arvind Singhal, chairman of Technopak.

A few small shop-owning families in richer areas of the country are taking the easy way out. They are leasing their premises to big consumer brands such as Nike and Reebok, who will pay rents of more than 300,000 rupees a month, far more than the profits that most successful families can make with a traditional small vegetable, grocery or chemist's shop. A few are being more daring and are expanding their stores. Technopak is advising groups of small shopkeepers in various places on how to get together and gain at least some advantage of scale in purchasing and marketing.

“It will affect our whole market if one of the new stores comes here with lower prices, so we have to compete,” says Harsh Narang, whose family has run the Shri Sant Lal grocery and general store in Hauz Khas, a prosperous middle-class market in Delhi, for 50 years. He recently doubled the size of his shop and is considering an offer from Hindustan Lever, Unilever's Indian subsidiary, to help modernise. But fruit and vegetable sellers who work from pavements will have far less chance of survival. Jageshwar Prasad, whose family owns a tiny 90-square foot vegetable shop and pavement stall in nearby Malviya Nagar, says, “It will affect us very much because they will take both the rich and the poor customers with lower prices.”

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Media firms and private equity

Hot on the press

Nov 2nd 2006 | NEW YORK
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Why private-equity investors are so keen to buy media businesses

THE internet is generally regarded as a threat to the media industry as a whole, with newspapers as its first victims. So at first glance it looks odd that, on October 23rd, at least three private-equity firms reportedly made initial bids to buy the Tribune Group, a conglomerate with a market capitalisation of about $8 billion, which owns three of America's most prominent newspapers, the *Los Angeles Times*, *Baltimore Sun* and *Chicago Tribune*, as well as several television stations and the Chicago Cubs baseball team.

Private-equity firms are showing a keen interest in the wider media, too. Last week Clear Channel, which has 1,100 radio stations and a market capitalisation of $17 billion, put itself on the block by announcing that it is “evaluating various strategic alternatives”. The Dolan family is trying to take Cablevision, the cable company it founded, private; and Jack Welch, a former boss of GE, reportedly wants to buy the *Boston Globe* from its owner, the New York Times Company. Talk of an impending purchase of Bloomberg, a data and news service, was so widespread recently that its owner and New York's mayor, Michael Bloomberg, felt obliged to issue a statement to employees denying it is for sale. There is even speculation that Time Warner and Viacom, two huge media conglomerates, might become targets.

In Europe, VNU, a Dutch media firm, was bought for $11.6 billion earlier this year by two American private-equity firms, the Carlyle Group and Kohlberg Kravis Roberts (KKR). The biggest media deal so far this year was the purchase by a consortium of five private-equity firms of a Spanish-language broadcaster, Univision, for $13.7 billion. There is much speculation about a fresh bid for ITV, a British television network, for NTL, a cable firm, and for Pearson, owner of the *Financial Times* and part-owner of *The Economist*—or at least for its Penguin books unit.

In Australia, where new media rules allow foreign ownership, the Packer family firm has put its media arm, PBL Media, into a company jointly owned with a private-equity firm, CVC Asia Pacific. Sir Tony O'Reilly's Independent News and Media is taking APN News & Media private in conjunction with Providence Equity Partners, a private-equity firm.

Managers and shareholders like these deals because they are frustrated by the public market's valuations of their businesses. The Mays family has had enough of watching Clear Channel's share price stagnate; likewise the Chandler clan, which owns 12% of Tribune.

Private-equity firms like media companies better than public markets do. Public markets love a growth story. Private equity appreciates cash flow. Radio and television stations and even newspapers throw off loads of cash, which private-equity firms can borrow against, using this leverage to repay their equity fast. That is true even of businesses whose cash flow is in long-term decline, such as newspapers, as long as the rate of decline is relatively predictable. The biggest risk in many of the current batch of deals is that the private-equity firms discover the cash-flow models to be less predictable than they thought, says Colin Blaydon of Tuck Business School's Centre for the Study of Private Equity and Entrepreneurship.

Whilst some funds, such as Providence Equity Partners and Elevation Partners, have long focused on media, some of the big, generalist funds have lately been hiring expertise. Carlyle, a possible buyer of Tribune, recently recruited Norman Pearlstein, a former editor-in-chief of Time Inc, to help identify suitable targets.

Private equity may mean better management. Since Cox Communications, a cable firm, went private in 2004, it has benefited from the lack of both short-term market pressure and Sarbanes-Oxley-related

interference. KKR has installed a highly-regarded former GE executive to run the hitherto poorly managed VNU. But cutting costs can be hard. The *Philadelphia Inquirer*'snew private-equity owners found themselves facing a possible strike after they tried to lay off workers. America's tough restrictions on cross-ownership of different media businesses may pose a further obstacle to restructuring.

Private equity's biggest advantage today is its access to vast quantities of debt, on what old-time bankers might regard as recklessly generous terms. They can borrow at far higher multiples to earnings than the public stockmarket is willing to sustain. That makes it hard for public companies to compete against private-equity buyers.

It's a nice position for private equity, but also dangerous. Mr Bloomberg is said to be convinced that private-equity is overpaying, and that when they later face pressure to deliver returns, they will slash jobs to boost short-term profits. He does not want that fate for Bloomberg. Other media owners may be less troubled by such prospects and more interested in cashing in on the seller's market of a lifetime.

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BP

Beyond coincidence

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Critics detect a pattern in BP's recent woes

“WHAT BP experienced was a perfect storm where ageing infrastructure, overzealous cost-cutting, inadequate design and risk blindness all converged. The result was the worst workplace catastrophe in more than a decade.” The views of the speaker in this instance, Carolyn Merritt of America's Chemical Safety Board (CSB), carry particular weight for BP, a big British oil firm. She is supervising a federal investigation into a fire at a BP refinery in Texas last year which killed 15 people and injured 180.

AP

One former BP employee

The CSB, which will release its final report on the accident next year, argues that the overflowing tank that caused the fire was too small, had leaked in the past, and should have been replaced, but was not, due to penny-pinching. It acknowledges that BP had begun to tackle safety problems at the refinery before disaster struck, but suggests the firm had concentrated on the form, rather than the substance, of regulations. The CSB has no punitive powers—it is simply charged with figuring out what went wrong, and how the accident might have been avoided. But the relatives of dead workers who are suing BP can now use Mrs Merritt's remarks in a trial to begin on November 8th. Her words could also have a bearing on a criminal trial, if prosecutors decide to embark on one. Later this month, a panel chaired by James Baker, a former secretary of state, will issue a report on BP's general safety culture, fulfilling one of the CSB's earlier recommendations.

In other words, there is no end in sight for BP. Moreover, the fire at Texas City is only one of a number of embarrassing lapses of late. In March, it suffered a big oil spill near Prudhoe Bay in Alaska. In June, financial regulators accused its trading arm of rigging propane prices by cornering the market. In all three instances, BP is accused of ignoring earlier signs of trouble, and, in the case of the fire and the pipeline, of putting profits before safety. The firm admits to making mistakes, and has tightened procedures and strengthened oversight of the divisions involved. It says it was spending more than its rivals on maintenance, for example, and will now budget even more. But it insists there is no overarching failing of management or corporate culture.

Indeed, until recently, the prowess of BP's management had been one of the company's strongest selling points. Its boss, John Browne, was widely admired for cutting costs and streamlining management. Now some analysts wonder whether this strategy might have gone too far. As Fadel Gheit, of Oppenheimer, a financial-services firm, says of BP's top brass, “They were invincible, and now they are ordinary mortals.”

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Drug retailing

Big deal?

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America's biggest pharmacy chain buys a drugs middleman

AMERICA does not have a health-care system, according to Tom Ryan, chief executive of CVS, America's biggest pharmacy chain. “We have a sick care system,” he insists. Mr Ryan says he is determined to reshape his firm and his industry so that his countrymen can at last enjoy the “holistic, end-to-end, seamless approach to health care” they deserve.

As proof of his firm's grand ambitions, he has just unveiled America's largest ever health-services takeover, and the fifth-biggest deal overall in the health-care sector. On November 1st, CVS announced that it would acquire Caremark Rx, a big pharmacy-benefits manager (PBM), for about $21 billion in shares. PBMs manage the drug benefits that employees get from big organisations, ranging from corporations to unions to government agencies. The combination, if approved, will have revenues of some $75 billion and handle over a billion prescriptions a year.

There was much talk this week of synergies to come, pricing power to be gained through vertical integration and marketing innovations. CVS would get access to the 90m or so customers on Caremark's database, argued some, and so could direct personalised pitches at them based on their health profile. Edwin Crawford, Caremark's boss (perhaps protesting a little too much), was keen to stress that his hand was not forced: “This was not done out of weakness. Our earnings are doing well...We're not stupid people.”

And yet investors were not impressed. Shares in both companies fell on the news, taking with them shares of other PBMs. Some worry that the deal may not win anti-trust approval: PBMs and drug retailers have historically been quite antagonistic, and this cosy takeover might steer too much business to CVS. Others fear that this supposedly visionary deal may be driven more by necessity than either boss cares to admit.

Mr Crawford's comments notwithstanding, Caremark did not come into this deal from a position of strength—as shown by the fact that CVS offered no premium on its share price. PBMs are now facing a financial squeeze. Christopher McFadden of Goldman Sachs points out that clients have started to claw back much of the lucrative sales rebate (some prefer to call it kickback) PBMs get from drugs manufacturers. The sizeable profits they have made from generics also look as if they will peak, since 2006 is the biggest year for new generic drugs.

That points to something which will weaken CVS as well: Wal-Mart's recent moves on the generic front. The retailer is now making several hundred generic drugs available for just $4 for a month's supply, and clearly has ambitions to take on conventional pharmacy chains. Gordon Carey of IMS Health, a consultancy, also points out that pharmacies like CVS have suffered much as PBMs have diverted retail drugs traffic to mail-order.

So this deal was far less about a vision of health care than about economic pragmatism. But though it may have been their difficulties that drove these two companies into each other's arms, the resulting giant will be a force to be reckoned with on America's health-care scene.

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The drug industry

From bench to bedside

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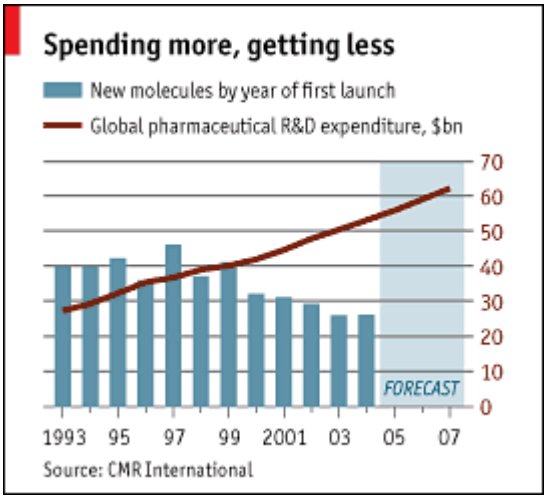
Could a new business model revive drug discovery?



"RAILROADS and telegraphs needed the modern corporation and semiconductors and software needed venture capital," says Gary Pisano. The Harvard Business School professor argues in a new book* that the drug industry is also in desperate need of a new business model. As the baby-boom generation ages, America, Europe and Japan will face an explosion in health-care costs unless researchers find new treatments.

Alzheimer's is a good case in point. The cost of caring for patients with the disease is estimated at $250 billion a year globally. Although Alzheimer's was identified 100 years ago this week, there is still no cure. More frustratingly, say experts, the majority of research money is not being spent on the most promising new areas of genetics. Why not?

The answer goes to the heart of what ails drug companies. Large pharmaceutical firms used to be engines of innovation, but a big fall in share prices, the onslaught of generic drugs and bureaucracy from recent mega-mergers has tripped them up. Research productivity and approval rates for mass-market drugs aimed at rich consumers are falling (see chart). Big firms have grown risk averse, developing lots of imitations of blockbuster drugs and fewer novel ones. The squeeze will get worse as a dozen top-selling drugs lose patent protection over the next two years.

Nimble biotech firms, however, have a good record of innovation. But the bursting of the biotech bubble has left them starved of cash. Except for a few stars like California's Amgen and Genentech, the industry makes no profits at all. Venture funding has shrivelled up in America, and Europe is not doing much better. The good news is that new business models and cash are coming. Three former executives from SmithKline Beecham, Novartis and Aventis have founded Care Capital, a $175m investment fund that favours novel drugs over "me too" bets. When Novartis recently got rid of a drug that failed to tackle Alzheimer's, for example, this group grabbed it for its potential as an obesity treatment. Kleiner Perkins, a legendary Silicon Valley venture fund, recently unveiled a $200m fund targeting research into pandemics. John Doerr, a partner at the firm, says it will invest to accelerate innovation, "and we're in a hurry."

Symphony Capital, an American private-equity firm with $315m allocated to drug-development financing, has done some two dozen unorthodox deals in which it pours money into new joint ventures in return for control of a firm's intellectual-property rights. The Milken Institute, a charity, recently convened a gathering of leading financiers, executives and relevant experts to craft even more unusual approaches to drug funding.

Charities and government agencies are getting cleverer too. They usually have lots of red tape, turf wars and are risk-averse. Rudolph Tanzi, a geneticist at Massachusetts General Hospital, believes this "sucks the life out of young investigators with sharp ideas." Most of the conventional research being done on Alzheimer's focuses on just four genes discovered many years ago that contribute only 30% of the genetic basis of the disease, ignoring the 20 or so uncharted genes thought to be responsible for the remainder of the problem. Mr Tanzi argues this ignores the most promising pathways.

His attempts to get official funding were rejected, so he turned to the Cure Alzheimer's Fund (CAF), which was started by several families with venture-capital experience. It provides funding quickly, but

with strict milestones, financial controls and supervision. It agreed to fund Mr Tanzi and a network of leading researchers. That has allowed them to get powerful statistical software and hardware for rapid genetic screening not yet in common use. The effort echoes the private-sector push to decode the human genome.

As a result, Mr Tanzi and the CAF team are well on their way to decoding the “Alzheimer's genome” within the next two years. This could lead to a cure. It might even produce a new business model to help cure the industry's own ills.

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* “Science Business” by Gary Pisano. Harvard Business School Press, to be published November 14th 2006.

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QB House

Barbers at the gate

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An Asian chain of cut-price hairdressers wants to offer more

THE stylist goes at you with all the gusto of a husband with a new lawn strimmer, but then QB House's boss, Kazutaka Iwai, says he always tells his staff that the barbershop chain's product is “not a haircut, but a shorter period of time”. This correspondent's preternaturally threadbare head is not the best site to test the stylist's skills, yet the buzzcut seemed to sharpen his looks up well enough. And he was in and out of that barber's shop in nine minutes flat.

QB (“Quick Barber”) House, founded in Japan nearly a decade ago, is a business that has thrived in a climate of falling prices. A typical Tokyo hairdresser (*biyoshi*) charges ¥5,000 ($43) for men—and a *karisuma* (charisma) *biyoshi* may charge easily double that. A good chunk of the money goes toward the *biyoshi*'s wardrobe and modish premises. Much of the rest goes in ritual: the wrapping in shrouds, the “consultation”, the endless hot flannels and the shoulder rub. QB House has none of that, not even a shampooing. A ¥1,000-haircut is offered. “We have turned barbershops from an emotional industry to a functional one,” says Mr Iwai.

And how. QB House outlets are squeezed into corners of railway stations and shopping malls. Many are deliberately placed next to a public lavatory. The company found that such busy outlets had turnover a tenth above the chain's average—and after travellers or shoppers have relieved themselves, a quick look in the mirror evidently reinforces the desire for a haircut. Inside, no telephone, or even cash register: a machine exchanges a ticket for cash, or you swipe the Suica smart card used on Tokyo's commuter lines. Stylists have their tools immediately to hand—the inspiration is said to have been a yacht's cockpit. The chain's 340 outlets now cut nearly 10m heads of hair a year in Japan.

Now QB House is taking the model abroad. The first attempt in Singapore was a disaster. After it opened 25 outlets, the incumbent franchisee reopened under a new, if similar, name. But QB House was heartened when the rival's expansion into Hong Kong foundered. QB House started afresh in Singapore, and has since opened in Hong Kong. Margins in these cities are similar to Japan's: higher rents are offset by lower wages. China, with very cheap labour costs (and haircuts), interests the company not at all.

Mr Iwai believes that the idea of quick, cheap haircuts can be extended further to other services: to massages, manicures and even instant loans. He envisages offering customers up to ¥1m in financing via banking services that are accessible from mobile phones. But QB House needs a stockmarket listing to grow. This summer, its retired founder sold 74% of the parent company to Orix, a Japanese financial-services firm. Mr Iwai and his colleagues are also borrowing to buy shares, with a view to a listing in a couple of years. “Only one who avoid [sic] wasting time can get profit”, says a sign hanging up in the firm's shabby headquarters.

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TCL-Thomson Electronics

A grim picture

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From The Economist print edition

Crashing prices make TV-set manufacture a horrible business to be in

FOR many great old names in the electronics business, TCL was a quiet assassin. Founded in China in 1982 to make magnetic tape in response to the mainland's hunger for the music trickling in from Hong Kong and Taiwan, it became a huge force in the television-manufacturing industry, where its modestly priced, mid-tier product crushed established but less efficient Western competitors.

Two years ago, in an iconic deal between a Chinese manufacturer and an overseas company with a well-known brand, TCL became the dominant partner in a joint venture with Thomson Electronics of France. Thomson had bought its own place in the television market back in 1988 from General Electric, which had already decided that profits were more likely to come in future from producing programming that appeared on increasingly cheap and available televisions than from making the sets themselves.

With little fanfare, TTE (short for TCL-Thomson Electronics) became the largest television manufacturer in the world. But additional size, and household brand names, did not spare it from the harsh competitive pressure that GE foresaw. In its first year, the joint venture lost HK$599m ($77m), followed by another HK$1.5 billion in the first three quarters of this year. In sum, almost half of shareholders' equity quickly disappeared, and the value of TTE's shares on the Hong Kong stock exchange collapsed.

While TTE suffered all over the world, there were sharp differences between regions. Profits slid just a bit in China, where TCL had a particularly strong franchise, and in other poor countries, where bizarre and costly import restraints favour clever manufacturers who are willing to ship televisions disassembled to precisely the level required under the law. These are then pieced together and branded by local companies. In America, where both TCL and Thomson operated, the joint venture even came close to breaking even. But in Europe, Thomson's home market, disaster struck. TTE lost €159m ($203m) on sales of €328m this year.

On October 31st TTE announced that most of the European operations in the joint venture with Thomson would be shrunk, sold, closed, or returned, including a factory in Poland and an expensive distribution network. Even Thomson's brand name will be largely gone in two years time. TTE will instead concentrate on producing TV sets to be sold by other companies, with none of the cost of support and distribution that a brand requires. Even better, supervision for this kind of business can be based in China.

A big problem was that both TCL and Thomson focused on clunky old models made using cathode-ray tubes. But the market has changed. Customers are rushing to buy TV sets with flat screens. The 2004 merger now looks as if it may have diverted energy from the single critical issue of the moment: a technological inflection point.

But even that does not completely explain TTE's troubles, since lots of flat-screen panel manufacturers are not doing particularly well either, even in the face of roaring demand. TTE reckons that in Europe, only Sharp is profitable. Flat-screen manufacturing facilities cost billions of dollars; in return for this investment, producers must watch the price of their product drop by as much as 10% a month, as competition is so rampant.

With the rapid fall in the price of flat-screen panels, TTE believes the key element for success is not so much the technology—the panel—as the inventory. A conventional TV set takes 90 days to make and send to America, by which time the price will have fallen. TTE wants to shorten that to less than 30 days, including the 20 days it takes the TVs to cross the Pacific. Boats used to be seen as time-wasting transport, but are now regarded as floating warehouses holding products while sales are arranged. “TTE has only one year to be really good,” says Aaron Tong, one of TCL's senior managers. “If we stumble, we

will be gone forever.”

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Face value

The reluctant briber

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Getty Images

A year in the life of an ordinary Russian entrepreneur (who, strangely enough, would rather not be named)

CALL him Ivan. When *The Economist* met him, on a flight from Moscow to Ukraine, Ivan was perplexed. Before the “orange revolution” of 2004, he said, “I knew who, when and how much” to bribe, on behalf of the small minerals company he co-owned in Ukraine. All the new talk of wiping out corruption was making business impossible. Ivan mostly works in Russia, his homeland. He is just the sort of small entrepreneur that the country needs to flourish, if its economy is to rely less on oil and gas, and its society to be stabilised by the growth of a middle class. Ivan has the strong stomach and dark sense of humour needed to survive the everyday perils of doing business in Russia. As he proved in a series of meetings over the last year, he is also enlighteningly candid.

Like many successful Russian businessmen, Ivan, who is in his 50s, had a scientific training, which meant he was not too exposed to Soviet indoctrination. He owes the once unthinkable lifestyle he now enjoys—foreign holidays, overseas education for his children—mostly to his dealings as a commercial-property developer. When *The Economist* saw him next, he was finishing a profitable project near Moscow. It was profitable not only for him. “It's like the last days of Pompeii,” he said of the bribe-taking that consumed roughly a tenth of his costs, the same proportion, he said, as criminals extorted in the 1990s.

Ivan's experience is typical: despite theoretical improvements to the registration and tax systems, President Vladimir Putin himself remarked last year that anyone who successfully registered a business in Russia deserved a medal. Vague and overlapping regulations can seem expressly designed to enrich predatory officials. Outright seizures of firms by criminal raiders, usually in cahoots with security or justice officers, are frequent. Ivan's project required dozens of licences, and every licence needed a bribe. Despite new rules that are supposed to restrict them, he faced a procession of bogus inspections by fire, health and other agencies. Mostly, he said, the bureaucrats don't demand cash explicitly; they just procrastinate until it appears.

Ivan's other big problem—labour—is also a money-spinner for corrupt officials. The old system of vocational training, he told *The Economist* six months ago, has collapsed with the Soviet Union; these days, economists are easier to find in Moscow than manual labourers. Today's Russians, he complained, are only interested in “easy money”. Drunkenness is another worry for employers (a common lament, which a new “register of non-drinking men”, set up by an entrepreneur, whose members will be vetted by the wives of alcoholics, is intended to address). There is no choice, Ivan says, but to use illegal

immigrants and pay off the police. Polls suggest that Russian businessmen fear bureaucrats more than criminals, and dread the police most of all. They charged Ivan 500 roubles ($19) per month for each of his illegal workers. Still, at least the kickback system is intelligible. Ivan once started a venture in America which ran up against local sanitation rules: “no-one would take a kopeck”, and the project folded.

For a while Ivan believed things might be changing for the better at home. The system seemed to offer him discounts for repeat custom: working on a second development in the same town near Moscow, he found that the bribes were lower (though he was also being leaned on to contribute to local schools, a common form of soft extortion). He also thought he might be benefiting from a short-term anti-corruption push. The federal government, he speculated, wanted to show that at least some parts of the country were functioning properly. He believed Mr Putin's regular vows to fight graft.

Meanwhile, the situation in Ukraine was still unpredictable. Ivan doubted that the “orange” government was any less corrupt than its predecessor: “they all say that”, he said of the anti-corruption slogans. For the time being, a sort of paralysis had set in among local officials. Almost no bribes were being taken, except the odd bottle of vodka, and nothing was getting done.

Worse before it gets better

By last week, Ivan had turned despondent about Russia too. New people had taken control of the town he was working in. They didn't care, he said, that he had helped to create hundreds of jobs there; they were squeezing him out of the development with exorbitant demands in favour of their pet firms. That disappointment tallies with recent surveys that suggest graft in Russia is actually worsening. Old bureaucrats have found ways around new rules. The periodic firings of disgraced officials have come to seem like the fallout of government infighting, rather than part of a genuine war on corruption. Mr Putin's promises, Ivan has now concluded, are “just paper and words”.

Like everything else in Russia's economy, the small-business sector is hard to measure precisely. Though it seems to be growing, obstacles like those Ivan faces are helping to keep it much smaller as a share of employment and GDP than in Western countries. But Ivan, at least, is still optimistic about Russia in the long run. Crooked officials may be as old as Russian literature, but he sees today's rampant corruption as a specifically post-Soviet illness. The Soviet regime bred nihilism among government officials but, he says, the fear that once restrained the worst of it has gone. Pen pushers with small government salaries shamelessly “go to the Canary Islands” on expensive holidays. Yet that mentality will eventually die out as a new generation of people go into business, Ivan believes. He himself regards the methods he is obliged to use with a sort of wry disgust.

Meanwhile, although he no longer wants to do business in Russia, things are returning to normal in Ukraine. The team that ran the country before the revolution is back in power, and Ivan once again knows who, when and how much.

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About sponsorship

BASF and the chemical industry

BASF and the chemical industry

Molecular weight

Nov 2nd 2006 | LUDWIGSHAFEN
From The Economist print edition

By defying industry fashion and exploiting the power of the "cluster", the world's biggest chemical company keeps growing

AFP

IN GERMAN, it is called the *Verbund*. Jürgen Hambrecht, the chief executive of BASF, describes his company's sprawling complex of pipes, towers and storage tanks as the "ultimate business cluster". Spread over ten square kilometres (four square miles), it is the biggest integrated chemical site in the world.

At first glance, BASF's third-quarter results, out on November 2nd, did not look great. Profits plunged because of restructuring costs at Engelhard, an American producer of catalysts (as in catalytic converters) which BASF bought earlier this year. And, on the same day, BASF announced 2,000 job losses.

But the underlying trend at BASF is surprisingly healthy, given that it is an old-fashioned manufacturing company in a part of the world where heavy industry tends not to flourish these days. It more than doubled its profits between 2002 and 2005. One-off charges aside, its third-quarter results suggest the company is in line for a 20% increase in turnover this year to over €50 billion ($64 billion), with pre-tax profits up 11%. Although many industries are fleeing from Europe to less costly countries, the efficiencies of the *Verbund* show how a traditional business can remain highly competitive, even when it operates in an expensive place like Germany.

The complex at Ludwigshafen, across the Rhine from Mannheim, comprises up to 250 individual chemical factories turning out 8,000 different products. These range from simple petroleum distillates to sophisticated nanomaterials—tiny particles which can be used to change the properties of plastics or other substances. BASF employs about 36,000 people in Ludwigshafen, where it also has its headquarters. Many travel around the site on red works bicycles, individually numbered.

The site's legendary efficiency comes from extracting the last drop of value from every chemical reaction. It makes use of the numerous by-products from each process. At other places these are often sold or shipped from one factory to another for further processing. At the *Verbund*, what is left over from one process is used only a few hundred metres away to make something else. This saves BASF a fortune. Compared with having, say, 70 separate factories some 100km apart, BASF calculates its cluster enjoys

annual savings of €300m ($380m) in logistics, €150m in energy and €50m in infrastructure.

For Mr Hambrecht, the *Verbund* represents a huge advantage in an industry in which competition is increasing, especially in Asia. So BASF is trying to replicate the benefits of its cluster, not only in other countries but also at the corporate level. Instead of splitting into lots of firms specialising in one chemical, as many giants have done, BASF is seeking to become an even bigger conglomerate.

Mr Hambrecht, who is 60, has spent half his working life at BASF, which was founded in 1865 as Badische Anilin- & Soda-Fabrik. Anilin was once important in making dyes; soda is used in glass, soaps and textiles. Today the company's products end up in goods ranging from cars to electrical goods, cosmetics, sports equipment and medical devices.

Mr Hambrecht enthuses about “the industry of industries”. Indeed, chemicals seem to be in Germany's blood. The country accounts for a quarter of the chemical industry's sales in Europe and a similar share of employment there. Germany supplies more than 12% of world exports of chemicals, the biggest single share. And the German industry spends a higher proportion of its revenue on research and development than that of any other country.

In many countries, chemical factories are hardly the subject of civic pride. They are in Germany. In September an “open day” attracted thousands of visitors. Frankfurters, in particular, are proud of the huge chemical complex straddling the river Main at Hoechst, west of the city. Though Hoechst, once the local chemical giant, was absorbed into sanofi-aventis of France in 1999, its Frankfurt site still churns out polymers, pigments and pharmaceuticals. The former Hoechst headquarters, a redbrick relic of the 1920s, is an admired piece of Bauhaus architecture.

Yet few sites are as efficient as the *Verbund*. A recent study of Germany's chemical industry by A.T. Kearney, a consultancy, found that most other production centres had big gaps in their “value chain”: raw materials and by-products had to be shipped around, at extra cost. The reasons are often historical or political. A complex at Leuna in east Germany, for example, was cleaned up at huge expense after German unification. It has never achieved its potential, even though firms such as Dow Chemical, Linde, Total and BASF have operations there. Other sites are too small or are underused, but cannot be closed for political reasons.

BASF has recently been adding to its product range in a big way. In March it bought Degussa Construction Chemicals, part of a German maker of specialty chemicals, for €2.7 billion; in May it spent $470m to buy America's Johnson Polymers and in June it paid $5 billion for Engelhard, the cause of the profits crash.

Asia starts producing

Although these European and American additions bolster its business, BASF cannot ignore developments elsewhere. Ever bigger petrochemical and other downstream production facilities are being built in the Middle East. And burgeoning demand in Asia, particularly in China, is resulting in more chemicals being produced locally. Moving into developing regions can have benefits beyond lower production costs. It can allow chemical companies to get closer to both suppliers of raw materials and more potential customers.

It nearly always makes sense to produce bulky chemicals, such as washing powder, where they are sold, to keep transport costs low. This puts places like China, which is a long way from the big Western consumer markets, at a disadvantage in exporting some products. But there are plenty of others to be made. Anything that can be conveniently put into a container and shipped cheaply is likely eventually to be made in Asia's low-cost factories.

Hence even BASF is having to shed businesses in which it thinks it is no longer competitive. The next to go may be a factory in Minden, Germany, which among other things makes caffeine. The Chinese now offer caffeine, which is easy to ship, to firms such as Coca-Cola at a third of the price that European factories can.

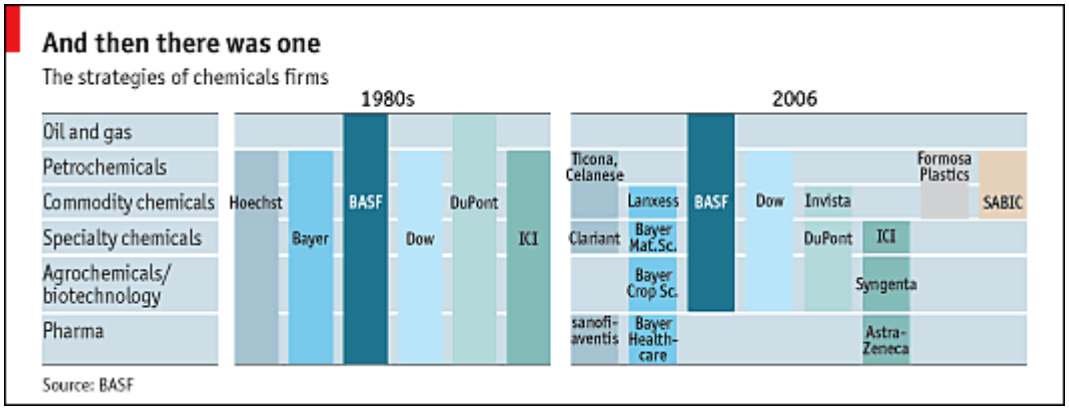
Nevertheless, demand in China is so great that it will be many years before the country becomes a net exporter of chemicals, Mr Hambrecht believes. Demand across Asia is strong. Around half of future worldwide demand for chemicals is expected to come from the region. BASF already has almost 19% of its turnover in Asia, up from just 9% in 1995.

As it expands overseas, BASF is trying to replicate the *Verbund* concept. It has built smaller versions of the cluster in Belgium, Texas, Louisiana, Malaysia and China. The foundations of its Chinese factory in Nanjing were laid in 2001. Last year petrochemical production began there in a joint venture with Sinopec, a Chinese oil company. Mr Hambrecht, who fought internal opposition to the investment, believes that such opportunities in Asia offer European chemical companies their only chance to grow faster than at home.

Chemical companies can be highly vulnerable to changes in the price of raw materials. Here too BASF hopes to gain some protection from its cluster effect. As long ago as 1969 it bought Wintershall, an oil producer. It has proved to be a useful hedge against oil-price rises. BASF is now trying to secure its lines of supply from Russia by a joint project with Gazprom to build a gas pipeline across the Baltic. It also has a share in a west Siberian oilfield.

BASF was mining coal until the late 1980s, and today even that might again make sense. The company's expansion into energy seems set to continue: it recently announced plans for a joint-venture biodiesel plant in Belgium, which will use rapeseed and other organic material to produce fuel. Indeed, oil and gas provided 40% of the group's profits in 2005.

Other giants in the chemical industry have spun off various divisions to narrow the spectrum of their business (see chart). For instance, Bayer, Germany's second-largest chemical firm, listed its specialty chemical division, Lanxess, as a separate company in January 2005. Although the trend in the industry is to put new labels on bits of the business, such as “life sciences”, which includes health and food, or “coatings”, which includes paint, BASF still brands itself as “The Chemical Company”. The one business it has quit is pharmaceuticals, accepting that there is little overlap between drugs and its other products.



The diversity of its operations makes BASF unpopular with some investors because it muddies their view of the firm as a “pure play” on chemicals. Mr Hambrecht is unrepentant. He argues that conglomerates are better overall long-term performers than specialists. Through diversity, he maintains, companies can weather poor performance in one or two of their divisions. The specialist can also be more vulnerable to disruptive technology and the sudden substitution of one material for another. This is a particular risk for the chemical industry in Germany, which is highly exposed to the car business. Almost 70% of the German industry's innovations, such as smarter or lighter materials, go into vehicles.

But it is harder to apply the *Verbund* effect in the developing field of biotechnology. A big handicap for BASF is the German government. Despite vowing in its coalition agreement last year to clear the way for genome technology, the government has since dragged its feet. Bayer is developing genetically modified rice, rape and cotton, but in America not Germany. BASF has the majority of its biotech research in Europe and believes Germany to be an excellent place for genome activities. But, says Mr Hambrecht, the government's attitude risks driving it away.

The virtue of virtuality

Perhaps the biggest danger to the *Verbund*, and the conglomerate-building which it encourages, is that it could lack the flexibility to cope with rapid market changes. But a variation of the concept might overcome this. This is the “virtual” *Verbund*; a large chemical site where a number of independent companies could voluntarily work together to achieve the same economies of scale, but use different processes as market conditions change.

A.T. Kearney suggests that something like this might be done at some of the chemical sites in Germany where production capacity is underused. A European Union project supported by seven big companies, including Siemens and Degussa, is trying to get the idea going by streamlining test-production. Called Impulse, the project aims to reduce the cost and time of research and development by miniaturising test equipment. This would primarily benefit smaller, more flexible companies. The political objective is to keep jobs and factories in Europe.

Perhaps such initiatives might one day steal away some of the *Verbund*'s advantages. But not yet. For now Mr Hambrecht, whose contract with BASF runs until 2011, is confident in the future prospects of his firm. As he jogs through the vineyards near his Rhineland home in the early morning he can indulge in thinking up new things to make. One fantasy is that in the future solar energy will be stored and put to work chemically, much as it is in plants through photosynthesis. This will require special ingredients, which no doubt the *Verbund* could find room to make.

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China's investment

Dim sums

Nov 2nd 2006 | HONG KONG
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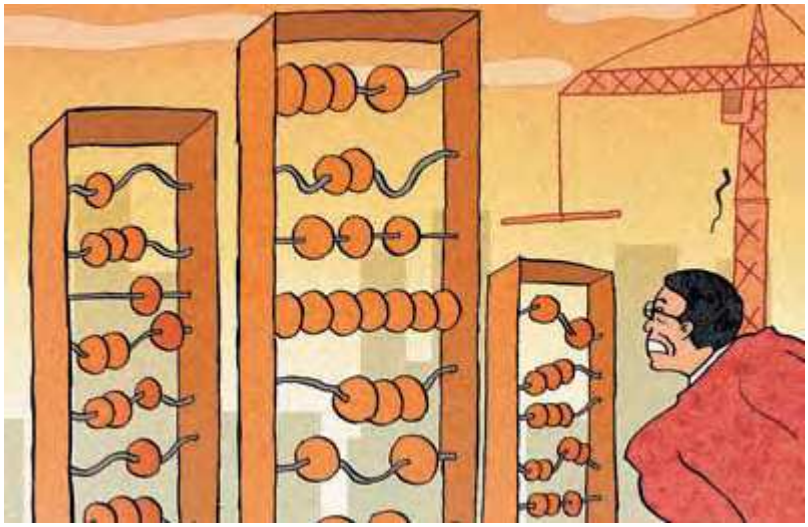
The widely held belief that China overinvests is based on flawed figures

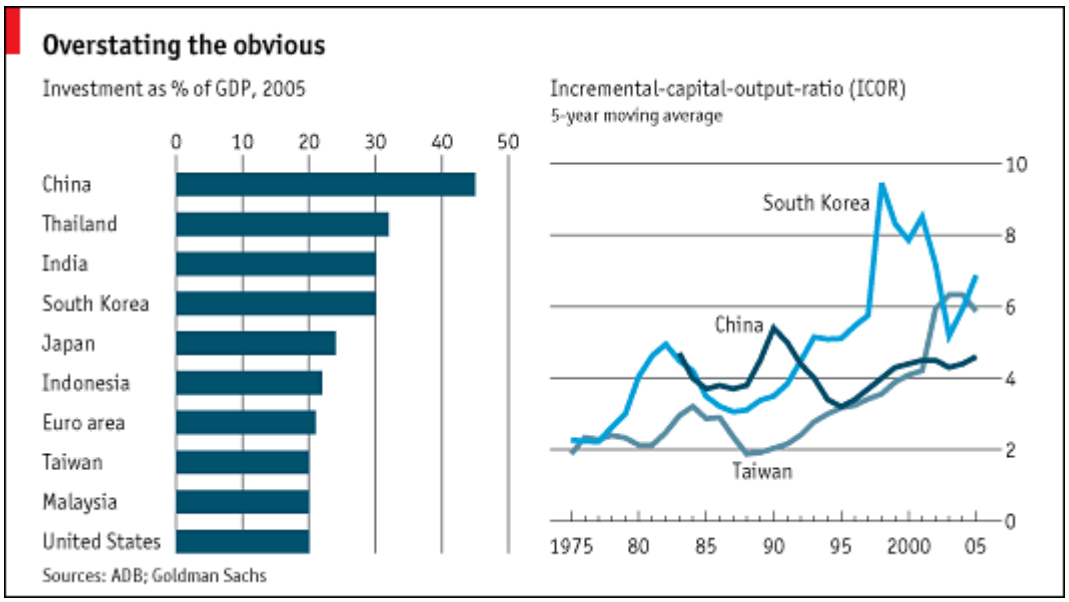


Get article background

CHINA'S national bird, it is said, is the crane. They loom all over cities, as ever more skyscrapers, car factories and steel plants are constructed. Concern that the investment boom is out of control has forced the government to clamp down on new projects. As a result, investment in fixed assets was up “only” 24% in the year to September, down from growth of more than 30% earlier this year.

But most commentators believe that China's investment is still too high, and that vast overcapacity will result. Sooner or later, it is argued, a sharp slump in capital spending will bring the economy crashing to earth. Not only will the boom end in a cyclical bust, but inefficient investment will also drag down China's long-term growth rate.

According to government figures, China's investment amounts to over 45% of GDP, which is hefty by international standards (see left-hand chart, below) and even higher than the levels reached in East Asia before the 1997 crisis. However, some statistical detective work suggests that this number cannot be right; correctly measured, investment is considerably lower, and therefore less alarming, even if it remains bigger as a share of GDP than in most other countries.



China's official figures are riddled with such inconsistencies. For example, the numbers reported for the growth in both GDP and fixed investment are incompatible. If investment accounts for 45% of GDP and it grows at an annual rate of around 25%, then simple arithmetic shows that investment alone should cause output to rise by 11% a year, even without any increase in consumption and net exports. Yet, according to government figures, consumer spending and net sales abroad have been contributing another six percentage points to annual GDP growth. That could imply that overall economic growth is an incredible 17%, compared with the merely astonishing 10% that it is currently running at. But it is more likely that the reported ratio of investment to GDP is much too high.

There is another big discrepancy between the figures for investment and saving. In theory the gap between the two should equal China's current-account surplus, which was 7% of GDP last year. If the reported investment ratio of 45% of GDP is added to that, the national saving ratio becomes 52% of GDP. Yet most studies estimate a much lower figure. A recent paper by the World Bank suggests that China's total saving rate is 44%. If that is correct, subtracting the current-account surplus (presumably one of China's more accurate numbers since it consists of trade with other countries) from that figure would imply a less hair-raising investment rate of 37% of GDP.

Hong Liang, an economist at Goldman Sachs in Hong Kong, concludes from all this that both the level and growth-rate of Chinese investment are overstated. The monthly figures for fixed-asset investment, which are closely watched by economists, are based on total capital spending by firms. This includes purchases of land, which reflect only changes in ownership, not increases in value added, which GDP tries to measure. The annual national-accounts measure of fixed investment is supposed to exclude land transactions, but Ms Liang reckons that the numbers fail to adjust fully for the surge in the cost of land in recent years.

At the same time consumer spending is almost certainly higher than official figures suggest, because services are still poorly covered. Indeed, underestimates of consumption are probably larger than overestimates of investment, which would imply that total GDP is itself understated. If investment is lower and GDP higher than official figures suggest, then investment may really account for 36-40% of economic output, says Ms Liang.

Capital punishment?

That still sounds excessive. In developed economies the average investment ratio is 21%. But the optimal level of investment depends on a country's stage of development. It needs to be higher in a poor country with rapid growth because its capital stock is so much smaller in relation to output and the labour force, and so it needs to catch up. America and Japan have more than 30 times as much capital per person as China. As an economy grows it needs to expand its capital stock simply to keep the ratio of one to the other constant, so the faster the rate of GDP growth, the more investment that is needed to support it.

If China were massively overinvesting, then the return on capital would be falling. But, as the World Bank has recently pointed out, corporate profit margins in China have been rising, not falling, during the

current investment boom. This hardly supports the widely held notion that too much investment is creating vast industrial overcapacity.

Another measure of the efficiency of investment is the incremental capital-output ratio (ICOR): the investment needed to generate an additional unit of output, measured as annual investment divided by the annual increase in GDP. Figures for China have risen sharply since the early 1990s, from three to over five. In other words, to get an extra $1 of output, China now has to invest $5 compared with only $3 previously. Many commentators conclude from this that investment is producing lower returns. Worse, China has a higher ratio than India, implying that it is more wasteful.

However, the ICOR is a poor measure of the efficiency of investment both over time and between different countries. First, as argued above, China's figures overstate investment. A second problem is that as an economy develops and becomes more capital intensive, more investment is required to support a given amount of GDP growth. So it is hardly surprising that India has a lower ratio. Indeed, whereas other economies have seen their ICORs rise over time, the underlying trend in China has been slightly downwards since reforms started in 1978 and it is now lower than in other East Asian economies (see right-hand chart, above). Furthermore, China's rapid development has required massive infrastructure investment in roads, ports and housing. This tends to undermine the return on investment in the short term, because the money is spent now, whereas the returns are spread over many years into the future, unlike manufacturing investment where they appear sooner.

Lastly, the ratio is calculated using gross investment, ignoring depreciation. But a large slice of investment in China has been to replace the poor-quality industrial base created during its command-economy era. Based on net investment, Ms Liang calculates that the ICOR has averaged a more modest 3.1 in recent years, lower than in many other economies.

This is not to deny that China has seen overinvestment in some sectors, such as steel and cars. Some projects are bound to be unprofitable given its badly functioning financial system and government meddling. It would be wrong, however, to dismiss the whole of China's investment boom as a bubble that is doomed to burst. China, which invented the abacus as we know it today, should tell its statisticians to fix theirs.

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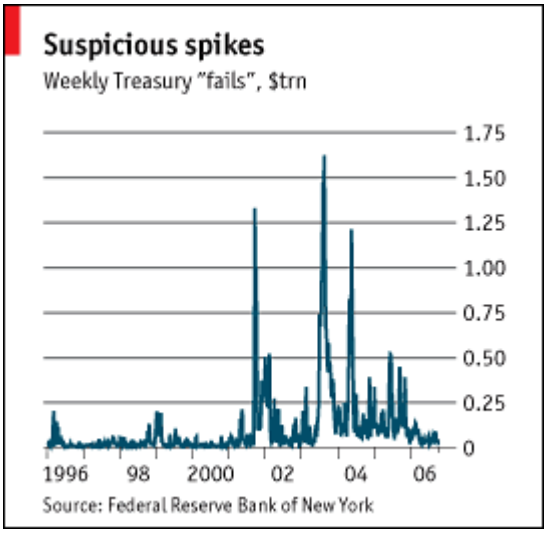
Treasury bonds

Repo men

Nov 2nd 2006 | NEW YORK
From The Economist print edition

Strange goings-on in the giant market for American government debt



DON'T even think about it. That is the message from financial regulators to those tempted to manipulate the $4 trillion market in American government debt. This week it emerged that the Securities and Exchange Commission (SEC) had opened an investigation into the activities of treasury bond dealers at UBS, Europe's largest bank by assets. Another Swiss bank, Credit Suisse, is also in the spotlight after a bond trader left under a cloud.

At least no one can say that they didn't see it coming. Regulators have been wagging their fingers for months. On September 27th James Clouse, a Treasury official, told an uncomfortable audience from the Bond Market Association, a trade group, that although the market was “highly efficient almost all the time”, the last two years have seen an increase in questionable practices among its 22 prime dealers (those licensed to buy paper directly from the Federal Reserve). In some cases firms appeared to have gained control over scarce issues, then used that power to distort prices and make a dishonest buck.

How might they do this? With some note and bond issues, it seems, banks can “squeeze” the market by getting their hands on much of the paper and then restricting supply, sometimes by parking it with custodian banks. When notes are in short supply, holders can profit by using them as collateral for loans. They do this in the busy repurchase (repo) market, where treasuries are sold for cash with agreement to buy them back later. The scarcer the security you want to swap, the lower the interest rate you pay for the cash, known as the repo rate. On some issues this year the repo rate has fallen close to zero.

Rising interest rates may have encouraged traders to play this game. Overnight money now costs 5.25% after 17 straight hikes. If a little market-cornering gets you funds in the repo market for a small fraction of that, why not? The onset of electronic trading, and the resulting tightening of spreads, has only increased the temptation. Some dealers might see the gains on offer as fair reward for taking on risk and making markets. But Mr Clouse views it as “an exercise in monopoly pricing”.

It is hardly surprising that the Treasury is touchy. The market for its debt is the world's deepest and most liquid, with an average daily volume of $600 billion—many times more than America's share markets. It is not only where the government borrows but also where the Fed implements monetary policy. And, crucially, it provides the risk-free benchmark against which other credit is measured. If it is not squeaky clean, investors could turn tail, raising the country's borrowing costs.

Traders argue that manipulating the market would be difficult because of its size. And regulators concede that large positions held by banks can be benign. Nevertheless, the financial policemen may be onto something. One cause for concern is the sharp increase in treasury settlement “fails” in the past few years, caused by a failure to return securities on time to the lender (see chart): these tend to jump when the repo rate is low and bonds are scarce. Another is the reported fall in the number of bonds in short supply after Mr Clouse's ominous speech. Coincidence?

Mr Clouse said there could now be a “strong sense of history repeating itself”—a reference to the scandal at Salomon Brothers in the early 1990s, in which the investment bank was caught dodging rules on

treasury auctions in order to gain control over certain issues. In its aftermath, senior heads rolled and regulators introduced a joint surveillance programme: these days the Treasury, the Fed and the SEC compare notes on the market every fortnight. They may now feel it's time to get tougher. The Fed's New York arm, which oversees the banks, and the Treasury will air their concerns at a meeting with the prime dealers on November 6th.

Among those present will be UBS, which must now try to ensure that any bad smells at its bond-trading desk do not pollute other businesses, particularly its prized wealth-management arm. The bank delivered more bad news on October 31st, announcing a 21% drop in third-quarter profits. The cause was largely put down to poor trading: the bank admitted to, among other things, having been “incorrectly positioned” in the treasury market. Whether that applies in more ways than one remains to be seen.

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Buttonwood

War dividend

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High commodity prices are a bad omen for peace lovers

WHEN Katyusha rockets fly in the Middle East, the oil price tends to rise. The price of crude is now commonly seen as an indicator of geopolitical risk, a role traditionally associated with gold.

In the past wars have led to inflation and higher commodity prices. Fighting disrupts trade and prevents raw materials from being shipped from one country to another. In second-world-war Britain, a banana was the height of luxury.

But does the link only go one way? Just as wars may cause commodity prices to rise, might higher prices of raw materials lead to more wars? That is the argument of Marc Faber, a well-known contrarian and Hong Kong-based fund manager.

If he is right, then the surge in many commodity prices over the last few years may carry a disturbing message for everyone. Investors, in particular, should worry a lot more about geopolitical risk.

Higher prices are often a symptom of scarcity. When those scarce goods are vital for the smooth running of the economy (as oil is), it is natural for countries to get a bit desperate. One motivation for Japan's expansionary policy in the 1930s was the perceived need to secure raw materials. The oil embargo imposed on Japan by President Roosevelt in 1941 helped to provoke the Pearl Harbour attack.

Today's rising Asian power, China, is attempting to secure its commodity supplies by doing deals with producers. But even this approach is adding to political tensions since some of these deals are being done with regimes that America dislikes. Attempts to send peacekeepers to Sudan, or to impose sanctions on Iran, may be frustrated by Chinese opposition. In turn, that may increase hostility towards China in American political circles.

At the same time higher commodity prices are giving increased economic power to countries that dislike American hegemony. Russia has already used its gas supplies to put pressure on neighbours in Georgia and Ukraine. High oil prices have given Venezuela's Hugo Chávez and Iran's Mahmoud Ahmadinejad a chance to throw their weight about.

That brings us to another reason why high commodity prices lead to global tensions. Raw materials are usually found in troublespots, rather than liberal democracies (Canada and Norway being among the honourable exceptions).

This is no coincidence. Raw material wealth is often described as a curse, having an effect similar to inherited wealth on younger generations. Governments simply skim the wealth from the resource sector, rather than build up other industries or create legal structures that give property rights to the broad population. Corruption flourishes.

So high commodity prices tend to take money away from “nice” people and give it to “nasty” people. Falling commodity prices do the opposite. Mr Faber argues that it was the plunge in oil prices in the mid-1980s, as much as the arms race with America, that led to the collapse of the Soviet Union.

Furthermore, the presence of commodities in “nasty” countries often makes scarcity worse. International companies become reluctant to invest in countries where their property rights may not be respected and where political turmoil may disrupt production. New resources are not developed as quickly as the global economy needs.

Global warming may make matters significantly worse. Arguably, the recent surge in wheat prices (prompted by an Australian drought) is an early indicator of the potential for climate change to disrupt food output. If nations get twitchy about their oil supplies, how might they react if food, or water, are threatened?

Clearly, most investors have not seen higher commodity prices as inauspicious, merely as a symptom of robust global demand. Most measures of risk, such as stockmarket volatility or the spread (extra yield) on corporate and emerging-market bonds are low.

Perhaps this is because betting on geopolitical worries in recent years has turned out to be a mug's game. The American economy recovered quickly from September 11th, while the start of both Gulf wars triggered big stockmarket rallies. This year neither the Israel-Lebanon war nor the dispute over Iran's nuclear programme has led to the disruption of oil supplies. North Korea's nuclear test was a damp squib in market terms.

But just because markets have muddled through so far does not mean that they will always do so. The global economy is so interconnected these days that even a local disruption to supplies can have widespread effects, as Hurricane Katrina showed. Protectionism and “blaming the foreigner” are tempting solutions to harassed politicians. A hedge against conflict, in the form of cash, short-term bonds and gold, should be part of any portfolio. Failing that, buy a helmet.

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Vietnam and the WTO

Marketmaker

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The WTO is about to welcome another "non-market economy" into its ranks

EARLIER this year Ukraine became a market economy. That might surprise many Ukrainians, who were under the impression they had been living with free enterprise since prices were deregulated in 1991, the currency became convertible in 1996, and the government began to off-load its assets, leaving about two-thirds of the economy now in private hands. But on February 17th, David Sampson, America's Deputy Secretary of Commerce, was delighted to announce in Kiev that in his government's eyes Ukraine was now a "market-based economy".

Vietnam may have to wait until 2019 for a similar benediction. On October 26th it finally agreed a deal to become the 150th member of the World Trade Organisation (WTO) once formalities are completed around the turn of the year. Almost 12 years of talks, resulting in 880 pages of policy commitments, have picked over many bones of contention, including Vietnam's textile export subsidies, which it has promised to eliminate, and its banking system, which it has pledged to open up by next April. There was also time over the past 12 years to broach less weighty, but equally delicate matters, such as Vietnam's import ban on Harley Davidsons, and fears that it might block imports of the Bible because it contains "culturally reactionary and superstitious material".

The WTO is built on the principle that members will treat each other alike. But as one price of entry Vietnam agreed to remain on a list of so-called "non-market economies", alongside China and several other WTO members, most of them former Soviet republics. This stigma has one practical consequence. It makes it harder for Vietnam to defend itself against the charge of dumping.

Dumping occurs when an exporter sells a product abroad for less than it charges at home, or for less than it costs to make. Rather than welcoming these bargains, importing countries tend to cry foul and raise anti-dumping duties. But how do they know that an import is too cheap? In a non-market economy, America's Department of Commerce argues, prices are not set by supply and demand so they cannot be trusted. Instead, it comes up with its own calculation of "normal value" based on costs in other "surrogate" countries.

America is Vietnam's biggest market and one of the more prolific users of anti-dumping duties. But it is not the only place to brand its trading partners as unmarket-like. Last month the European Union (EU) confirmed that Vietnam was dumping leather shoes, based on what it costs Brazil—the chosen surrogate—to make them. Last year it imposed duties on Vietnamese bicycles, after comparing them with bikes made in San Luis Potosí, Mexico.

The most notorious case remains, however, Vietnamese catfish, or "basa" fish as they are now labelled so as not to upset fish-farmers in the Deep South. In 2003 America's Department of Commerce hit imports of the fish with duties of 37-64%. It reached this decision after calculating what Vietnam's fillets would cost if they were reared on a fish farm in the Kishoregonj region of Bangladesh, using water bought in India, transported by Bangladeshi truckers, with labour purchased at a price the department thinks should prevail in Vietnam, based on its income per head.

What must Vietnam do to shake off the "non-market" label? The EU, the Americans and others each have their own requirements. America wants to see the removal of price-fixing and currency controls, even more foreign investment, free wage bargaining, and limited government ownership.

But "the economic logic is invariably something of a façade," argue Adam McCarty and Carl Kalapesi of Mekong Economics, a consultancy in Hanoi. The only criterion that really matters is that America's retailers, who like Vietnam's cheap merchandise, lobby harder than its garment-makers and catfish

farmers who hate it. It is mostly those with something to fear from open markets who accuse other countries of falling short of them.

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Income trusts in Canada

Death and taxes

Nov 2nd 2006 | OTTAWA
From The Economist print edition

The government cracks down on a stockmarket moneyspinner

CANADA'S finance minister, Jim Flaherty, drove a stake through the heart of the fastest-growing sector of the Toronto Stock Exchange on Halloween, announcing a crackdown on income trusts that he said were being increasingly used by companies to dodge taxes. It was the latest attempt by successive governments to discourage corporations from converting to income trusts, which have become popular vehicles for shifting the tax burden from companies to investors. Judging from the dismayed reaction of the Toronto stockmarket, which plummeted the day after the news, his stake hit its mark.

Income trusts were first set up in the mid-1980s by mature property and energy companies who chose to pass on all of their profits to investors and thus avoid corporate income tax. At that stage the loss to the treasury was minimal. The haemorrhaging has increased during the past five years as businesses as diverse as pizza chains and telephone directories jumped on board, luring investors with higher but riskier yields than they could get from dividends or interest-bearing investments.

When two of the largest telecommunications firms in Canada—Telus and BCE (the owner of Bell Canada)—announced plans to switch to trust status this autumn, pushing estimated tax losses to more than C$1 billion ($885m) a year, the government could no longer sit idly by. Both companies said on November 1st that they were re-examining their options. But not before their shares dropped sharply.

For the government the problem is not so much individual investors, who hold about 39% of the 247 publicly traded income trusts worth C$200 billion. They pay personal income tax on the distributions. But cash going to pension plans, with 39%, would be taxed only in the hands of future beneficiaries. And foreign investors, with 22%, pay only a 15% withholding tax. Mr Flaherty plans to tax distributions of new trusts next year and those of existing trusts in 2011.

Although angry investors sputtered about the surprise announcement, citing Conservative campaign promises to leave the sector alone, the portents were all there. The previous Liberal government tried to limit pension investment in income trusts in 2004 but backed off when the pension industry objected. In 2005 it denied advance tax rulings to potential converts and then lowered the tax on dividends to make income trusts less attractive. All to no avail: there was another C$70 billion in announced conversions this year alone.

While you would not know it from the outcry, the trust sector was already beginning to fray around the edges as some of the riskier vehicles cut distributions and saw their unit prices fall. Small investors, who had been attracted by the promise of regular payments, had already begun to protest about them.

Is this truly the end? Some investors hope the government will reconsider and allow exceptions for the original energy and property companies. The more optimistic point out that 2011 is still four years away. A buying opportunity for some, a lingering death for the sector.

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Bank regulation

A battle over Basel 2

Nov 2nd 2006 | FRANKFURT
From The Economist print edition

A seven-year mission to make the world's banks more efficient runs into trouble

FOR the world's bankers, it has been the equivalent of seven years' hard labour: since 1999 banks have been cajoled, at some cost to themselves, toward a new regulatory regime that will affect the all-important cushion of capital they hold to prevent a run on deposits.

So when Klaus-Peter Müller, the head of the Association of German Banks, issued a warning two months ago that Basel 2, as the new framework is known, might fail, there was a note of despair in his voice. Since then things have got, if anything, worse.

Soon after Mr Müller's gloomy warning came a Senate hearing in Washington, DC in late September. A succession of American bank regulators each cautioned against the sophisticated methods of Basel 2 unless they could also preserve a cruder measure of banks' lending exposure, the leverage ratio. Introduced in America in 1991 in the wake of a housing-loans crisis, the leverage ratio ensures that a bank's core capital is at least 3% of its balance sheet, whatever the quality of its loans and its risk-management systems.

The leverage ratio could now be exported to other jurisdictions too. Sheila Bair, chairman of America's Federal Deposit Insurance Corporation, put it on the agenda at a recent meeting of the Basel Committee, the panel of rich-country regulators which devised the Basel rules, prompting what has been called euphemistically a “frank exchange of views.”

For Mr Müller and his fellow German bankers, who have spent fortunes on upgrading to the new Basel rules, mentioning a leverage ratio is like calling for the cat o' nine tails. The Germans are not alone. Bank regulators in practically every country have been working on Basel 2. They have devised a system for banks in about 100 countries to hold levels of capital that more closely reflect the actual risks borne by the bank in terms of the credit rating of borrowers, the exposure to derivatives and the volatility of securities. At the highest level, banks' home-grown risk calculations are trusted to set the standard.

The European Union has gone as far as passing a Capital Requirements Directive which binds banks in member states by law to start complying with its version of Basel 2, in stages, from January next year. Other places, such as Hong Kong, have written rulebooks that they will also begin implementing from next year.

By contrast, the four main American agencies which supervise banks finally posted a “notice of proposed rule-making” on September 25th. The notice, which triggered congressional hearings, says that Basel 2, if and when the American version ever sees daylight, will be applied only to internationally active banks—around 26 at present. All other banks will be regulated by Basel 1A, which contains a few elements of Basel 2, but retains the leverage ratio. Even the 26 banks readying for Basel 2 will be forced to cling to the leverage ratio as a safety measure.

Naturally, the big American banks are annoyed at having their wings clipped in this way. Big European banks are irritated too. First, because any American subsidiary they have will be subject to the same regime. Second, because they have invested millions in a risk-based system that was meant to be applied and harmonised worldwide—the Americans will not introduce their version of Basel 2 until 2009 at the earliest. Smaller European banks are annoyed because their American equivalents do not have to spend time and money complying with Basel 2 at all.

American banks with subsidiaries in jurisdictions applying Basel 2 will have to start complying there—which makes reconciliation with the numbers given to their American supervisors quite a challenge.

Likewise American supervisors, luddite though they may be, have promised to help their foreign counterparts by inspecting the Basel 2 risk-calculation models used by foreign banks on their soil.

Since Basel 2 is being applied in stages anyway—full compliance in the EU is not due until 2008 and any capital reductions have a moving floor over three years—the American foot-dragging is not disastrous. Moreover, the collywobbles of the American regulators do have some basis.

Test runs on the possible effects of Basel 2 have suggested that some banks, particularly American ones, could slash their capital by 31%. That alarmed their regulators since Basel 2 was meant to reduce some banks' capital cushions only marginally and increase others. But they should console themselves that they have flexibility under Basel 2 to reward or punish risk-management performance, as do the rating agencies. If they feel banks are letting go of too much capital, there is still plenty that they can do about it without resorting to the blunderbusses of the past.

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Economics focus

Winds of change

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Why economists love empires

IN A speech last year at Oxford University, Manmohan Singh, India's prime minister, caused a stir in his homeland by noting a few “beneficial consequences” of India's years under British rule, including its free press, its civil service and its “notion” of the rule of law. But he also pointed out that India, one of the world's biggest economies in 1700, was impoverished by the time the British left.

However mixed empire's legacy in India, imperialism has recently provided a rich feast for economists. Their interest lies not just in totting up the balance sheet of colonial rule—although that can be fascinating. They are after even bigger game: an explanation of why some countries grow rich and others do not. Of the many proposed solutions to that riddle (technology, geography, the Protestant ethic) the current favourite is rather bland in the abstract: “institutions”. In rich economies institutions—meaning the formal laws and unwritten rules that govern society—function rather well on the whole. In poor ones they don't. That much is indisputable.

What is tricky is showing that good institutions are a cause of economic progress rather than a by-product of it. You cannot run controlled experiments in which a particular institution is randomly imposed on some countries, but not on others, in order to compare how they fare. Or at least economists can't. But perhaps imperialists can. Maybe the colonial adventures of the past provide the natural experiments economists need to put their theories to the test.

The imperial powers certainly generated a lot of institutional variety, sprinkling Spanish vassalage, British indirect rule and American paternalism across the globe. But was this variation random? Surely not. Imperialists vied to plant their flag in the most lucrative spots, wherever the spices were rich or the sugar cane tall. Thus a conundrum remains: if, say, America's former colonies have prospered compared with Spain's, was this because America bequeathed the best institutions, or because it found the most promising areas of the world to colonise?

What is ingenious about the recent economic studies of empire is how they overcome this problem. Imperial institutions may determine prosperity, but the reverse may also be true. The trick is to find some third factor that is securely linked to institutions, but entirely unconnected to economic success. Such factors are called “instrumental variables”, because the economist is interested in them not for themselves, but for what they tell him about something else.

That name, however, now seems quite ironic. Because all of the fun in the recent spate of papers is in the instruments themselves. Economists are outdoing each other with ever more curious instruments, ranging from lethal mosquitoes to heirless maharajahs, or, most recently, wind speeds and sea currents.

An imperial variable

Guam, which became a Spanish colony in the 17th century and an American one at the end of the 19th, was discovered in 1521 after winds and swells carried Ferdinand Magellan, the Portuguese-born explorer, to its shores. In a recent study of 80 such islands, all but one of which eventually fell under the imperial yoke, James Feyrer and Bruce Sacerdote of Dartmouth College argue that winds and currents dictated which islands were colonised when. The early colonialists went where their sails took them; only after steamships became the norm in the 19th century could they travel against the wind.

As a result, some islands were colonised early, some late, for reasons that had much to do with

meteorology, and rather little to do with any other intrinsic attractions the islands might offer. The two authors show that the accessible islands, which lay on natural sailing routes, have prospered relative to the others. They put this down in part to the longer period these islands spent under colonial rule. A century as a colony is worth a 40% increase in today's GDP, they argue.

But as the authors point out, this striking result disguises a more disturbing fact. On many islands the original population was decimated, or worse, by European contact. After the Spanish colonised Puerto Rico in 1505, the native population fell from 60,000 to 1,500 within 30 years. The island may have since prospered, but the original islanders did not.

The study paints the British as relatively benign rulers compared with the Iberians. But instruments can cut both ways. Lakshmi Iyer of Harvard has used the technique to reveal some unhappy consequences of the Raj that might have made Mr Singh's Oxford audience squirm. The British, she points out, did not wrest direct control of India all at once. From 1848 to 1856, for example, the governor-general pursued a “doctrine of lapse”, taking charge of states whenever the native ruler died without an heir. These states, then, came under British rule as a result of patrilineal misfortune, not economic potential. Ms Iyer shows that such areas had fewer schools, clinics and roads as a result of British rule. The effects lingered into the 1980s.

Once just an obscure statistical method, instrumental variables are now popping up all over the place. Daniel Hamermesh, a labour economist at the University of Texas, has joked about the “instrument police”, who patrol empirical economics, forever suspicious that causality may run both ways. Indeed, “reverse causality”, which was once a frustrating problem, is now seen as a chance to demonstrate ingenuity. Instruments have brought colour to the study of institutions, and sharpened the debate over colonialism, without really resolving it. But whatever the claims of empire, the instrumental variable now enjoys an almost imperial grip on the imagination of economists.

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Marine biodiversity

Every little fish

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New research points to a better way of protecting fish stocks

Photographer's Choice

EVERYBODY knows that global fish stocks are heading for collapse. That is why governments try to limit the amount of fish taken out of the sea. But recent research suggests that the world is going about regulating fishing the wrong way—that fish stocks would fare better if efforts were made to protect entire ecosystems rather than individual species.

There are plenty of data to prove the importance of diversity on dry land. Until recently, however, there was little evidence that the same was the case in the oceans, which make up 90% of the biosphere, and on which a billion people rely for their livelihoods.

In order to establish whether diversity matters in the sea as well as on land, 11 marine biologists, along with three economists, have spent the past three years crunching all the numbers they could lay their hands on. These ranged from the current United Nations Food and Agriculture Organisation's database to information hundreds of years old, gleaned from kitchen records and archaeology. The results of their comprehensive analysis have been published in *Science*.

Marine biodiversity, they report, matters because it is variety *per se* that delivers services—such as maintaining water quality and processing nutrients—to humans as well as the goods people reap from the sea. It also ensures these goods and services recover relatively rapidly after an accident or natural disturbance. The new work is silent on exactly how biodiversity protects these things—merely showing that it does. Earlier work though has shown some possible mechanisms. One example from a study in Jamaica showed that continuously removing algae-grazers from a reef allowed the algae to overwhelm the coral.

The latest study, led by Boris Worm of Dalhousie University, in Halifax, Canada, gathered the available material into four separate groups. The researchers found the same result from different pools of data, in different types of marine ecosystems and at different scales.

Trawling the data

In the first the marine ecologists re-examined 32 small-scale experiments in which researchers had altered the variety of sea life and recorded what happened. Overall, each of the six ecosystem processes

examined—which included the maintenance of stability and improved water quality—worked better when there were more species than when there were fewer.

This is not as obvious as it may seem. Until now, some scientists have thought that many individuals of the same species with certain talents could perform specific tasks better than the same number of individuals from different species. For example, one type of seagrass may process nutrients more effectively than other types, so a bed devoted entirely to the talented seagrass might be expected to conduct this processing better than a mixed area. The research suggests this is not so.

Second, Dr Worm considered estuaries. Marine extinctions are uncovered slowly on a global scale, but local disappearances are much more rapidly apparent. They collected long-term historical records from 12 coastal areas in Europe and North America, including information on the Roman elimination of the Dalmatian pelican from the Wadden Sea and the removal of the Atlantic sturgeon from the Chesapeake Bay and the Delaware Bay.

Analysing these data revealed that estuaries and coastlines are less able to maintain, for example, water quality, as the number of species found within them declines. Going back over several centuries, when biodiversity falls, people desert the beaches, coastlines become more liable to flooding and blooms of algae are more likely to gain a footing.

That theory was tested on a third group of data—records kept by the United Nations from 1950 to 2003 of the fish and invertebrates caught in large expanses of the ocean all around the world. These data make up 83% of all records of all catches of fish over the past half-century. Dr Worm and his colleagues discovered that the more species an ocean region has, the more robustly it seems to cope with overexploitation.

The findings suggest that governments should rethink the way they try to manage fisheries. Marine reserves are common in the tropics, but policymakers in temperate countries tend to focus on one species at a time to control numbers of that species caught. They might do better to spend more time thinking about ecosystems and less haggling over quotas.

Policymakers might do better to spend more time thinking about ecosystems and less haggling over quotas

Some governments claim to have already come around to the idea. In America, Britain and Canada officials are considering how to redraft fisheries policy. Scientists hope that the move will push the inevitably unhappy compromise between their recommendations and fishermen's aspirations closer to their way.

Dr Worm's fourth analysis showed that the damage could be reversed. In it, he pooled data from areas where fishing had been banned, either because stocks had collapsed or because the space had been designated as a marine reserve. These included the Georges Bank off the east coast of America and Canada, where disastrous overfishing for cod threatened the collapse of stocks.

On average, the number of species in the 44 sites increased by 23%. In the areas around the protected regions fishermen reported catching, on average, four times as many fish per trip as previously. The researchers also examined whether the recovery was sufficient to make the protected areas more resilient to storms and changes in temperature, but the results were not statistically significant.

Dr Worm reckons that, the way things are going, commercial fish stocks will collapse completely by 2048. The date may be spuriously precise, but the danger is there. And so, if Dr Worm is right, is a better way of making sure that it doesn't happen.

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Human evolution

Eyeing up the collaboration

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The whites of the eyes suggest early humans were co-operative

THE sight of a group of men standing round watching another man work on his car is familiar in cultures throughout the world. It is also an example of what seems to be a primal human interaction—the mutual direction of gaze. Indeed, being able to identify what someone else is looking at is thought to have been so important to humans that people evolved to have eyes surrounded by brilliant whites to assist with the process. Now new research from Germany backs up the idea.

People, more than any other primate, depend on their fellow humans to figure out where to direct their attention. Previous research has shown that human children are much more willing than chimpanzees to co-operate with a human adult in manipulating objects—for example, taking it in turns to drop a ball down a chute. And when the children do, they spend a lot more time looking at the face of the adult, monitoring where that person is looking.

Humans also happen to have scleras—the white part of the eye surrounding the iris—that are much bigger and brighter than the scleras of other primates. In fact, most other primates have scleras that are so dark that they camouflage which way the eyes are looking. The theory is that a white sclera surrounding a darker iris and pupil helps people work out where everyone else is looking. If this were correct, people might be expected to pay more attention to the eyes than do other primates.

So researchers at the Max Planck Institute for Evolutionary Anthropology in Leipzig, Germany, decided to compare adult chimpanzees, gorillas and bonobos with human children of a year or 18 months in age. In the experiment, reported online in the *Journal of Human Evolution*, a human adult first attracted the attention of the non-human ape or the human child, and then looked up at the ceiling. The experimenter moved only his eyes, moved his head and his eyes, or moved his head and kept his eyes closed. In later versions of the experiment he also turned around so that only the back of his head was visible and then either moved his head up or stayed still.

Both the non-human apes and the human children tended to look where they thought the experimenter was looking. But the non-human apes paid the most attention to where the experimenter's head was pointing, in particular, looking up when the head was pointed up, no matter what the eyes were doing. Human children, on the other hand, paid the most attention to the eyes, and were relatively indifferent to where the head was pointed.

The idea that people evolved eyes that make it easy for others to see where they are looking suggests just how important sociability was for early humans. If human interactions were primarily competitive, it would be advantageous to camouflage eye movements, as other apes seem to have done. That way, it would be hard for a competitor to see someone eyeing a tasty banana or potential mate. Instead, people have evolved to make it easy for others to see where they are looking. The advantages of co-operation seem to have outweighed those of competition.

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About sponsorship

Space policy

Mercy mission

Nov 2nd 2006
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Astronauts will be allowed to upgrade the Hubble space telescope after all

EDWIN HUBBLE was the first astronomer to describe the expansion of the universe, in a physical formulation made in 1929 that now bears his name. On October 31st America's National Aeronautics and Space Administration (NASA) announced that it would further expand man's knowledge of the universe by allowing astronomers to repair and upgrade the telescope that is named after him.

Since its launch in 1990 the *Hubble* space telescope has captured beautiful images of the universe, such as the birth of stars in stellar nurseries, while conducting rigorous science, such as the recent detection of planets orbiting stars near the centre of the Milky Way. In its 16 years of operation it has found the first convincing evidence for the existence of black holes, made observations supporting the theory that the universe's expansion is accelerating and confirmed that dark matter exists.

But the telescope is deteriorating. It has been in space for a long time. Dust and radiation are damaging its instruments. Without new batteries and new gyroscopes it would lose both the power and the ability to point in the right direction. It needs a service to extend its working life beyond the next two or three years.

A planned servicing mission was cancelled in January 2004 after the space shuttle *Columbia* was lost along with its crew of seven astronauts in 2003. NASA administrators deemed that future shuttle flights would be allowed to go only to the International Space Station, where astronauts could take shelter and await rescue, should the shuttle be damaged on launch.

Now the administration has had a change of heart. Part of the reason is that it turned out to be impossible to put together the alternative—a robotic mission to repair Hubble—before the telescope started to crumble. So officials re-examined the possibility of a manned mission. They found that the shuttle's orbit time could be extended by 25 days, and reckoned that, with a second shuttle on stand-by in case crew needed rescuing, the risk was acceptable.

The mission offers the opportunity not only to repair the telescope but also to upgrade it. It will get a protective blanket and two new instruments are to be fitted. A “cosmic origins spectrograph” will examine the structure and composition of the matter concentrated in the “cosmic web”—long, narrow filaments of galaxies and intergalactic gas separated by huge voids. To do this, it will examine what happens to the beams coming from faint, distant quasars as they pass through the cosmic web. Absorption of this light should reveal the composition and specific location in space of the constituents of the cosmic web, illuminating both the large-scale structure of the universe and the progressive changes in chemical composition of matter as the universe has grown older.

A second instrument, a new wide-field camera, will extend *Hubble*'s capability to see deep into the universe. Using it, astronomers will observe young, hot stars that glow predominantly in the ultraviolet part of the spectrum. They will also be able to see the first stars and galaxies that formed in the universe, which are now so old and distant that their light has been relegated to the infra-red part of the spectrum. These wonders can be seen only from space because water in the Earth's atmosphere absorbs light at these wavelengths.

The proposed upgrades should keep *Hubble* going until 2012. Its replacement, the proposed *James Webb* space telescope, is supposed to be launched the following year. There would be no way to repair and upgrade this telescope, though—it would be placed in an inaccessible orbit around the so-called second Lagrangian point, where the Earth, the sun and the moon orbit one another while remaining in the same position relative to each other. Webb was not an astronomer, but head of NASA in the 1960s—a sharp

indication of how the balance of power has shifted between scientists and bureaucrats.

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About sponsorship

Self-recognition

Mirrors of the mind

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Elephants join an elite club of creatures that can recognise their own reflections

HUMANS do not generally consider other people who spend hours preening themselves in front of mirrors to be particularly intelligent. Rather the reverse. But when an orang-utan dons sunglasses and then goes to a mirror to look at itself, scientists take this as evidence that it is more intelligent than most animals.

Zoologists are interested in an animal's ability to recognise itself because they think it indicates a capacity for empathy. The idea came about from studies of young children. Babies, like almost all other animals, interpret the image in the mirror as another person. Between the ages of 18 months and 24 months, though, toddlers develop the ability to recognise their own reflection. At around that time, children start to show sympathetic concern for others. The theory goes that a certain level of abstract self-awareness is required to attribute feeling to others and, since this happens as people learn what mirrors do, testing mirror recognition in animals might form a way of testing for empathy in other species.

Animals including chimpanzees, gorillas and dolphins have demonstrated this characteristic. These creatures all have large brains, complex social systems and occasionally behave altruistically towards distant relatives, strangers or even individuals of other species. That hints at a sense of empathy.

Evidence collected by Joshua Plotnik and colleagues of Emory University in Atlanta suggests that elephants belong to this group. The researchers studied three Asian elephants at the Bronx Zoo in New York. They put a specially reinforced jumbo-sized mirror into the elephants' enclosure. When Happy, Maxine and Patty saw the mirror, instead of trumpeting, as elephants often do when they meet another elephant in the wild, they tried to look behind the glass. They then seemed to be checking whether the elephant in the mirror exactly copied their own actions by rhythmically moving their heads in and out of view. All three elephants then seemed to use their reflections as a way of investigating their own bodies. Maxine slowly pulled her ear toward the mirror using her trunk. All three appeared to inspect the interior of their mouths, and took to moving their food so they could watch themselves eating.

The big test for checking whether animals recognise themselves involves painting a mark on their faces. Mr Plotnik and his colleagues placed a white cross above the elephants' right eyes and an invisible cross over the left eye, so that neither smell nor a memory of paint being applied should tell the elephants where the conspicuous marking was. They report the results in the current issue of *Proceedings of the National Academy of Sciences*.

Happy used her reflection to repeatedly touch the white mark with her trunk, which showed that she, at least, recognised her own reflection. The other two, however, did not. Unlike apes which spend much of their time picking dirt and lice off their skin and fur, elephant preening is more about rolling in mud than removing it. Maxine and Patty, named after Broadway beauties the Andrews sisters, may simply have viewed the dirty blemish as adorning their good looks.

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About sponsorship

The Palestinians

Nations and narratives

Nov 2nd 2006
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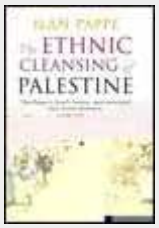
An Israeli academic who argues that Israel should confess to a deliberate campaign to expel nearly 800,000 Palestinians in 1948 is courting controversy at home

The Ethnic Cleansing of Palestine
By Ilan Pappe



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EPA

SO IS it to be 1967 or 1948? For watchers of the Middle East this question is shorthand for two different ways to think about the origins of, and solutions to, the long conflict between Israel and the Arabs of Palestine. In the eyes of the 1967 crowd, Israel was entitled to the borders it had before its abrupt expansion in the six-day war of that year. To make peace, the trick is therefore to create circumstances in which Israel will give up most or all of that land and allow an independent Palestinian state to arise in the West Bank and Gaza. That, as generations of failed peacemakers have discovered, is quite a tall order.

For the 1948 crowd, however, this way of thinking about the conflict is a mistake. They argue that peace is impossible unless Israel admits to and atones for the crime they say it committed nearly 60 years ago, in its independence war of 1948. That crime, they say, was deliberately to expel most of the Arabs of

Palestine, close to 800,000 people, in order to be sure of having a Jewish majority for the Jewish state. Unless Israel somehow makes amends for this earlier catastrophe, which the Arabs call the *nakba*, peace is an impossibility.

Ilan Pappe, a political scientist at the University of Haifa, is one of the purest Israeli exponents of the 1948 view. He knows how provocative it is to choose the phrase “ethnic cleansing” for the title of his latest book. But ethnic cleansing, he insists, is precisely what occurred in the first Arab-Israeli war. It was, he says, a long-premeditated crime, implemented ruthlessly and then systematically denied. In 1948 the Zionists did not happen to wage a war that tragically but inevitably led to the expulsion of parts of the indigenous population. The ethnic cleansing of all of Palestine, he maintains, was the main goal all along.

Inside Israel, the historiography of 1948 has been in ferment for more than 20 years. Israel and its admirers once clung to a simple collective view about the circumstances of the state's birth. In a Solomonic judgment, the United Nations voted to divide the contested land into a Jewish state and an Arab state. The Jews accepted the plan, but the Arabs tried to strangle the Jewish state at birth. In the course of the war that followed, the Jews overcame vast odds, guaranteeing their survival and expanding the territory allotted to them under the original plan. In the course of the fighting, most of the Arab population fled.

The last bit of this over-simple narrative has by now been comprehensively debunked. In 1988 Benny Morris, an Israeli historian, published “The Birth of the Palestinian Refugee Problem, 1947-1949”, challenging the view that most of the Arabs fled of their own accord, in panic or at the behest of the Arab states. In many towns and villages they were put to flight deliberately. Mr Morris said that there was no master plan to evict all the Arabs: many expulsions took place in the heat of battle and the fog of war. But he also argued that the idea of a population transfer had been carefully considered by David Ben-Gurion and the other Zionist leaders, and hovered behind their actions and deliberations.

Mr Morris and other “new historians” in Israel unleashed fierce argument. Other scholars accused Mr Morris of traducing Ben-Gurion through selective quotation. In a new version of “The Birth” in 2004, Mr Morris offered even more evidence of the extent to which the Zionist leadership hankered after a population transfer, and the alacrity with which they exploited the events of 1948 to bring one about. (Mr Morris also said, in an interview that stunned his supporters, that Israel was justified in uprooting the Palestinian “fifth column” once the Arabs had attacked the infant state, and that the number executed or massacred—some 800, on his reckoning—was “peanuts” compared with, say, the massacres in Bosnia in the 1990s.)

Mr Pappe, however, goes a good deal further than Mr Morris. He insists that there was indeed a master plan. On March 10th 1948, he asserts, 11 men met at the “red house”, the Tel Aviv headquarters of Israel's pre-state army, the Haganah, to put the final touches to Plan Dalet, “a plan for the ethnic cleansing of Palestine”. That evening, military orders were sent to units on the ground to prepare for the expulsion of the Palestinians. Mr Pappe calls this group of men the “consultancy”, an ad hoc cabal of political and military leaders dominated by Ben-Gurion. And population transfer did not just “hover” in the background of their thinking, he says. It was central from the start.

Still in a fog

You might suppose that after 60-odd years the story of 1948 would by now have been laid bare. Historians have access, on the Israeli side at least, to military archives, political minutes and personal diaries.

It is not, alas, so simple. The consultancy rarely kept minutes. Ben-Gurion was a prodigious diarist, but selective in what he recorded. Mr Pappe admits that he does not in fact know what Ben-Gurion said at the supposedly fateful “red house” meeting on March 10th. As for Plan Dalet, this is no new discovery by Mr Pappe. The plan has been public for decades and does not read unambiguously like a master plan for wholesale ethnic cleansing. The aim was to crush the Palestinian militias before the Haganah had to face the invading Arab armies. It gave commanders discretion to occupy or destroy and expel hostile villages or potentially hostile villages; some destroyed swathes of villages and a few did not. And Mr Pappe's detractors will ask why he ignores the orders sent out by the chief of staff of the Haganah, Israel Galili, on March 24th, reminding commanders of the policy to protect the “full rights, needs, and freedom of the Arabs in the Hebrew state without discrimination”.

Thanks to such inconsistencies, the history of 1948 will remain contentious. And like much of the “new history”, this book has the defect of treating the Palestinians only as victims, not as actors in their own right. But how much really turns on this debate among historians? Mr Pappe says that Zionism needs to acknowledge and reverse its original sin. But whether or not the population transfer of 1948 was premeditated (as he says), or largely opportunistic (as Mr Morris says), history can hardly be rewound over half a century.

Some thoughtful Israeli politicians have indeed acknowledged their country's portion of the blame. In his 2005 memoir, “Scars of War, Wounds of Peace”, Shlomo Ben-Ami, a former foreign minister (and historian) accepted that in 1948 an Arab community “in a state of terror” was put to flight by a “ruthless” Israeli army that perpetrated atrocities and massacres. This was done consciously to enlarge the borders of the new state. But whatever the moral case for letting back the refugees, Mr Ben-Ami says, after the war this was “out of the question in a historical and political context”, not least because of the illegitimate demands of the Arab states, who never accepted partition and indeed grabbed for themselves much of what should have been the Palestinian state.

As Ehud Barak's foreign minister, Mr Ben-Ami was part of the team that tried at Camp David in 2000 to make peace on roughly the border of 1967. Mr Pappe is not surprised that this failed. For the Palestinians, he says, “1948 is the heart of the matter and only addressing the wrongs perpetrated then can bring us closer to the end of the conflict.” But Mr Pappe wants Israel not just to apologise but also to let back all the Arab refugees, and so give up the idea of remaining a Jewish state with a Jewish majority. It is hard to imagine many Israelis agreeing to that, whatever they come to believe really happened in 1948.

The Ethnic Cleansing of Palestine.
By Ilan Pappe.
Oneworld; 313 pages; £16.99. To be published in America by Oneworld in December

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About sponsorship

American philanthropy

The blackened sheep

Nov 2nd 2006
From The Economist print edition

IN GIVING their fortunes away, Bill Gates and Warren Buffett are following the lead of Andrew Carnegie. But that is about all they have in common with the Scots-American who made his pile first by cheating investors in bonds and then through conspiring successfully to rig the market in steel. Unlike today's billionaire philanthropists, Carnegie had little interest in fighting poverty or disease, especially in what is now called the third world. Instead, he aimed to improve the minds of the “English-speaking race”.

Thus, in dedicating a library in Pittsburgh, one of the 2,800-odd he helped establish during his lifetime, Carnegie asserted in 1895 that it was quite wrong for a businessman to listen to entreaties for higher wages when profits soared. Nine out of ten employees would simply fritter any extra money away “upon richer food and drink, better clothing, more extravagant living, which are beneficial neither to rich nor poor”. Far better, he said, to direct the profits toward a great educative institution that lasts for all time.

Andrew Carnegie
By David Nasaw

Penguin Press; 878 pages; $35

Buy it at
Amazon.com
Amazon.co.uk

In a similar vein Carnegie argued that other philanthropists were misguided when they gave money to the unworthy. They would do better to throw their millions into the sea than to use them to encourage the slothful and the drunken. “Neither the individual nor the race is improved by almsgiving,” he once wrote.

His workers in Pittsburgh felt the full force of his pitiless Darwinism. He cut their wages and increased their work week to 84 hours as immigrants from eastern Europe poured into Pennsylvania desperate to find work. When his workers rebelled, he temporarily shut steelworks, refused to rehire union members and brought in agents from Pinkertons to deal with troublemakers. Things turned particularly nasty at the Homestead steel mill, where several striking workers were shot dead.

Against such a bloody backdrop, David Nasaw finds it hard to explain how he came to like as well dislike his subject. Peter Krass faced the same difficulty four years ago in his life of the robber baron, but tackled it by harping on about how the steelman's philanthropy “ultimately uplifted millions of people”. Mr Nasaw instead seeks to humanise Carnegie by giving more attention than other biographers have to the steelman's private life, drawing extensively on unpublished bits of his autobiography, love letters and the diaries of his relatives and close friends.

Not everybody will find it endearing to learn how little Carnegie practised what he preached. By his early 40s he had pretty much retired to a life of luxury in grand houses on large country estates where an army of servants catered to his every need. With time on his hands, he was able to badger the British and American statesmen of the day with unsolicited advice on everything from a Venezuelan border dispute and the status of the Philippines to the peaceful nature of the German Kaiser and the necessity for international disarmament. Presidents Teddy Roosevelt and William Taft were among those who pretended to listen hard lest he switch his allegiance, and his political contributions, to their opponents. In private they were less tactful. Taft dismissed him as “a peace crank”; Roosevelt viewed him with “contemptuous abhorrence”. They were not altogether fair. As Mr Krass stressed, and Mr Nasaw does not stress enough, Mr Carnegie did more good than harm with his money during his life—and after it.

Andrew Carnegie.
By David Nasaw.
Penguin Press; 878 pages; $35

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About sponsorship

Naval warfare

Blood brothers

Nov 2nd 2006
From The Economist print edition

WHY was so much American and British blood shed in the early 19th century? The battles now seem more like ritualistic duels than serious warfare, especially those that took place at sea. And the whole sorry affair, culminating in the so-called War of 1812, which actually spanned 1812-15, ended in an honourable draw. Neither side won or lost anything of any significance.

In this account of the early history of the American navy, Ian Toll seeks to explain not just how this happened, but also why. He succeeds splendidly. His factual story is as exciting as any of Patrick O'Brian's fictional seafaring tales and is also suffused with the naval jargon of the day. Such terms as futtock, knight-head and shallop might not now be widely understood but they help stimulate the historical imagination.

The American Congress, reluctant to raise the necessary taxes, was initially sceptical that the new republic needed a navy at all. It was persuaded to vote the money necessary for founding a fleet led by six frigates only when freedom of the seas for American merchant ships was threatened by North African pirates, naval restrictions at ports in the West Indies and by naval blockades imposed during the wars between Britain and France after the French revolution.

Six Frigates: The Epic History of the Founding of the US Navy
By Ian W. Toll

Norton; 592 pages; $27.95.
Michael Joseph; £25

Buy it at
Amazon.com
Amazon.co.uk

The battles that eventually ensued between British and American fighting ships provide an insight into a marvellously archaic form of unfriendly fire. When, for instance, the *Guerrière*, a British frigate, was shot to pieces by the *Constitution*, an American frigate, every gallantry was observed. Captain James Dacres, who was all of 28 years old, offered his sword in a token of surrender. Captain Isaac Hull, his American counterpart, refused, as custom demanded, to accept it. Dacres offered Hull fulsome compliments on the courage and performance of his men, remarking that the American crew had fought “like tigers”. The crews and surgeons of both ships then saw to the wounded and, in a ritualistic funeral, the bodies of an American officer and a British seaman were buried together at sea.

Another American captain, Stephen Decatur, was even more gallant when his frigate, the *United States*, destroyed a British frigate, the *Macedonian*. All of the personal possessions of the British officers were returned to them and Decatur gave $800 to the British captain, John Carden, to compensate him for the articles that he did not wish to take back with him to England. These included musical instruments and casks of wine. In his memoirs, Carden wrote: “I must here & always bear testimony to the marked Gentlemanly Conduct of Commodore Decatur.”

Another British captain cruising off Boston went further. Assuming gallantry would take precedence over tactical advantage, he sent a note of exquisite politeness to the captain of an American frigate, challenging him to sail out to engage him in battle, since “we are short of provisions and water, and cannot stay here for long”. Far from seeking to take advantage of such valuable intelligence on the enemy's vulnerability, the American captain sailed out only to be mortally wounded before his ship was seized in lethal hand-to-hand fighting by a British boarding party. Mr Toll is persuasive when he maintains that, “in a sense that jars modern sensibilities”, such men saw themselves as brother officers, “more deeply beholden to one another than to the civilian statesmen they served”.

All was not sweetness and light, though. Inevitably, some naval officers were cads. As seen through American eyes, Admiral George Cockburn was the worst of them. After he destroyed towns on the eastern shore, his name was as reviled in Tidewater, Maryland, as General Sherman's was in Georgia after he burned the state from Atlanta to the sea during the American civil war. But, in Mr Toll's book,

Cockburn is an exception. Most of the top naval men behaved as then befitted officers and gentlemen.

Six Frigates: The Epic History of the Founding of the US Navy.
By Ian W. Toll.
Norton; 592 pages; $27.95.
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About sponsorship

French fiction

A bad case of over-excitement

Nov 2nd 2006
From The Economist print edition

WRITTEN in French by an American, Jonathan Littell's new novel, “Les Bienveillantes”, has been the sensation of the *rentrée littéraire*, the French fiction season. Set for an initial print run of 12,000, it had sold nearly 200,000 copies by the end of September. A month later, the Académie Française awarded the book its grand prize for fiction; it is on the shortlist for two others including the Prix Goncourt, which will be announced on November 6th. Mr Littell, a former aid worker, is the son of a thriller writer. *Le Monde* likens him to Tolstoy. But is his book any good?

“Les Bienveillantes”—literally the “kindly ones”, but also a euphemism for the Furies of Greek mythology—is a former SS officer's account of his exploits during the second world war. Mixing reminiscence, self-justification and philosophical musings, Max Aue describes his work with a German death squad during the invasion of the Soviet Union. The action sweeps through the Caucasus, the Battle of Stalingrad and the Majdanek and Auschwitz death camps to Hitler's bunker in its last days.

Mr Littell's research is meticulous. Aue mixes with the leading historical figures of the time, and the intricacies of Nazi bureaucracy are depressingly real. But the novel founders under the weight of its own detail. The reader must endure an exploration of the origins of the Tats, a Caucasian tribe, and an equally drawn-out argument over rations allocated to inmates of concentration camps. Mr Littell's anti-hero shows signs of deep disturbance: an incestuous relationship with his sister, sado-masochistic homosexuality and a violent matricide form only a small part of a traumatic life. As the Third Reich crumbles, so “Les Bienveillantes” falls apart. In one of the last scenes, as Hitler pins a medal to his breast, Aue playfully tweaks the Führer's nose. At the Frankfurt book fair last month, publishers made frenzied bids for the foreign rights. They may be in for a pasting.

Les Bienveillantes.
By Jonathan Littell.
Gallimard; 912 pages; €25

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About sponsorship

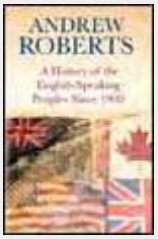
The English-speaking world

Going out in the midday sun

Nov 2nd 2006
From The Economist print edition

EVER since “Salisbury: Victorian Titan” won its then 36-year-old author the Wolfson history prize in 1999, Andrew Roberts has been seen as one of the most eminent young British historians. So it is no surprise that, in his tenth book, he turns to Winston Churchill for inspiration. Mr Roberts limits his range to countries where English is the first language: America, Britain and its former dominions, core countries which he sees as “the last, best hope of Mankind”, the source of the Rights of Man, free markets and the British Empire.

A History of the English-Speaking Peoples Since 1900
By Andrew Roberts



Weidenfeld & Nicolson; 736 pages; £25. To be published in America by HarperCollins in February

Buy it at
Amazon.com
Amazon.co.uk

George Bush described this recently as a “great book”. But Mr Roberts's work is less a history than a giant political pamphlet larded with its author's prejudices, with sneers at those who do not share them and with errors. Mr Roberts has the Red Army marching “eastward” across Europe in 1945 (one of three such reversals of geography); Britain's women's navy mis-spelled as “WREN”; similarly “Srebenica”, “Götterdämmarung”, Walter Laqueur as “Lacquer”; and, if you please, Luigi Barzini, an Italian journalist who in 1983 wrote “The Europeans”, as a character in Henry James's 1878 novel of the same name.

So far, so trivial. Less so are Germany's atrocities in (today's) Namibia being displaced to Angola; the *Lusitania* as an “American” liner; “only” the English-speaking armies being “still capable of mounting any kind of offensive in 1918”—the year of a huge German one. Britain's 1945 election was “postwar”; and the list of prime ministerial adulterers “while in office” includes John Major—whose one publicly known affair ended two years before he moved into Downing Street.

If the common reader can spot these errors, what about an expert? Was American opinion really as “galvanised” by the torpedoing of the *Lusitania* as by Pearl Harbour and September 11th 2001? Outraged, yes, but it took two years and German resumption of unrestricted submarine warfare in early 1917 (which Mr Roberts strangely postpones to that September) to bring America to war—surely the longest reaction-time in the history of galvanism. In boyish zeal, he rehashes the dubious British claims to have invented television and the jet engine. A Brit was just ahead of a German in the laboratory, but Germany had a jet flying 18 months earlier.

His broad judgments tend to be odder still. He thinks the right to bear arms “the final bulwark of American citizens' rights”. So America has no Supreme Court? He approves of the Versailles treaty after the first world war (indeed he says it should have been tougher) and of American support for some vile regimes and ghastly civil wars in Latin America. He is nostalgic for the Austro-Hungarian and Ottoman empires and in deep mourning for the British one. It certainly had real merits, but was the Delhi durbar of 1911 really “the proudest day of the English-speaking peoples' mission [sic] in India”? In Amritsar in 1919, ten minutes' firing by troops into a banned gathering killed almost 400 Indians, even by the official count. Mr Roberts gives five pages to this massacre, saying it restored order. Not even in those days did the home government accept that excuse.

Those five pages also typify his odd priorities. Why give a page to Jane Fonda's Vietnam antics; two to mocking a curious piece by Germaine Greer on Australia's “aboriginality”; almost four to Augusto Pinochet's 1973 coup in Chile (but no mention of the later murder of thousands of his opponents)? Perhaps because these give Mr Roberts a chance to get at his pet hates: lefties, anti-Americans and “liberal internationalists”. Some deserve it: nine pages chastise those on the British left who saw no evil in the 1930s Soviet Union.

Nine pages also go to justifying the 2003 invasion of Iraq. Fewer support the cause than did three years ago. But Mr Roberts spoils his case by smearing those who felt the subsequent bombings of a London bus and three underground trains may have been linked to Britain's involvement in the invasion of Iraq, by adding them to “those amongst the English-speaking peoples prepared to appease, apologise or even laud and aid their mortal enemies.”

Even when he is positive, Mr Roberts's views are open to question. Not least, his assumption, for all the space he gives their squabbles, of the essential unity of the English-speaking peoples. When your elder brother gets into a fight—nay, as in 1940, is fighting for his life—you forget squabbles and wade in, fast. The Dominions did so, in 1939 as in 1914. America both times waited well over two years. That was fully justifiable; indeed, the only course open to Presidents Woodrow Wilson and Franklin Roosevelt, given their public opinion. But that is just the point. Such was indeed American opinion: that of good friends, maybe, but not family.

A History of the English-Speaking Peoples Since 1900.
By Andrew Roberts.
Weidenfeld & Nicolson; 736 pages; £25.
To be published in America by HarperCollins in February

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About sponsorship

Amazon worldwide bestsellers

Crash course

Nov 2nd 2006
From The Economist print edition

A political bestseller list shows that Americans are concerned

THE Republicans are on the run. That, at least, may be one conclusion to be drawn from sales over the past month of American political books.

True, the independent-minded Bob Woodward tops Amazon's list of its ten biggest selling political books with his critique of the Bush administration at war. “State of Denial” has sold tens of thousands of copies and is not even in paperback yet. But seven of the books that follow Mr Woodward's are penned by men who are variously described as conservatives, neoconservatives, paleo-conservatives or just plain old-fashioned traditionalists. And they all focus on classic Republican worries: culture wars, moral values and the conservative soul, signalling that in the weeks running up to the mid-term elections, at least, worried Republicans have been shelling out more for books than their Democrat counterparts.

Yet if a week is a long time in politics, a day is an age in a bestseller table. By October 31st, 24 hours after the end of the period covered by this list, Amazon boasted a new political author at the top of its list: the junior senator from Illinois, Barack Obama, a Democrat.

Poll of politics

1	**State of Denial: Bush at War, Part III**	by Bob Woodward
2	**America Alone: The End of the World as We Know It**	by Mark Steyn
3	**Hubris: The Inside Story of Spin, Scandal, and the Selling of the Iraq War**	by Michael Isikoff and David Corn
4	**Culture Warrior**	by Bill O'Reilly
5	**State of Emergency: The Third World Invasion and Conquest of America**	by Patrick J. Buchanan
6	**The Conservative Soul: How We Lost It, How to Get It Back**	by Andrew Sullivan
7	**Against All Enemies: Inside America's War on Terror**	by Richard Clarke
8	**The Greatest Story Ever Sold: The Decline and Fall of Truth from 9/11 to Katrina**	by Frank Rich
9	**Dangerous Nation**	by Robert Kagan
10	**Faith and Politics: How the "Moral Values" Debate Divides America and How to Move Forward Together**	by Senator John Danforth

Source: Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr & Amazon.jp from October 1st-30th 2006

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About sponsorship

Ralph Harris

Nov 2nd 2006
From The Economist print edition

Lord Harris of High Cross, economist and freedom-fighter, died on October 19th, aged 81

PA

ON NATIONAL No-Smoking Day, March 8th 2000, two suspicious figures were seen loitering outside the Houses of Parliament. One, in a loud red coat and louder lipstick, was Baroness Trumpington, with a clay pipe. The other, straight, thin and moustachioed, in a trilby and exotic waistcoat, was Lord Harris of High Cross, with a Meerschaum.

Ralph Harris loved smoking. He kept two more pipes in his pockets, in case one sputtered out. But as the years passed he loved smoking less for the tang of the tobacco, or its stimulus to thought, than for its defiance of the nanny-hand of the state. As smokers were increasingly repressed and made outcasts by the "authoritarian itch" of governments, so he all the more fiercely took their side.

He too had been out in the cold, like them. When he became general director of the Institute of Economic Affairs ("my little institute", as he fondly thought of it), in 1957, he was pushing ideas that were deeply out of fashion in the Keynesian post-war years. The IEA, set up by Antony Fisher in 1955, promoted deregulation, privatisation, tax cuts, trade-union reform and the free market. It attacked the welfare state, incomes policies and—Mr Harris's particular *bête noire*—high public spending that unleashed inflation. These opinions were so outside the bounds that Mr Harris compared the IEA in those years to a band of 30-year-old boys fooling with fireworks. Or, perhaps, lighting up in a non-smoking carriage; for when he went to give talks in universities in the 1960s, most of the audience would walk out.

To critics, the ideas of the IEA were all the worse for being "German". Their source was Friedrich Hayek, in fact an Austrian. Mr Harris, fresh down from Cambridge in 1947, had fallen under the spell of Hayek's "The Road to Serfdom". Serfdom was all around him then: ration books, travel restrictions, the persistent shadow of wartime central planning, and most of all the depressing disposition of people to do what they were told and to suppose that this was modern life. He never believed it. The way to freedom was to unleash the millions of individual actions that made up a working economy, and never to seek to control them.

Slowly, these ideas caught on. Arthur Seldon, his chief collaborator, made the IEA's papers readable, while Mr Harris proselytised among movers and shakers and, most usefully, raised money. The IEA

stayed aloof from party politics—essential, Mr Harris believed, to avoid embroilment in “vote-getting, lying and cheating”—but sought to change the intellectual climate in which politicians had to operate. Geoffrey Howe and Keith Joseph, the chief brains of the Conservative Party, deeply inhaled the new air; and Joseph passed the IEA's papers to his favourite pupil, saying, “Here, Margaret, read this.”

The moral science

Mrs Thatcher adored Mr Harris's ideas. He admired her, and was amazed at the vigour with which she took on the unions and defended the free market through the 1980s. He did Thatcherite things, such as chairing the Bruges Group that opposed the European Union (though on grounds of interventionism, not the single market) and founding in 1985 a fan-club called No Turning Back.

Yet he was not a Thatcherite in his bones. From his lowly beginnings, on a council estate in Tottenham in north London, he understood the “emotional case” for socialism, and worried about minimum levels of spending on the poor. He did not oppose safety nets, only “hammocks”. When Mrs Thatcher made him a life peer, her first such appointment, he chose to sit on the cross-benches where he could vote as he pleased, as a “radical reactionary” or, more accurately, a classical liberal. Offered a coat of arms, he refused it because he could not adorn it with Adam Smith's invisible hand.

He sometimes regretted he had not lived in Smith's time. To him, economics—or at least his variety, the economics of freedom—was a religious belief, the “moral science” that Smith had taught. The law of supply and demand, he once wrote, was the nearest social science approached to the laws that governed the universe. The modern conception of economics was much too small a canvas for him.

Nonetheless, he could use the jargon for all it was worth. Speaking in the House of Lords in July 2005, he railed against “statistical jiggery-pokery”, “selective surveys” and “spurious precision to two decimal places”. The numbers he was pulling apart, this time, were not government predictions for economic growth or industrial output—nonsense, he always thought, implying the sort of comprehensive knowledge humans simply didn't have—but figures for deaths by passive smoking, which he refused to credit. He suspected that untruths were being peddled to curb liberty, and he was having none of it.

John Stuart Mill might have disagreed with him; freedom, he wrote, must be limited when it injures others. Even Adam Smith might have found fault with the unhindered working of a smokers' market. But Lord Harris could see priggish tyranny at work. That was the only “false step” he ever attributed to Hayek; that, during a spell of bad health, he had let other people persuade him to give up smoking.

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Overview

Nov 2nd 2006
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America's GDP grew at an annual pace of 1.6% in the third quarter, compared with 2.6% in the three months before. It was the slowest rate of growth since 2003, largely because of a 17.4% decline in residential construction—the biggest such contraction in more than 15 years.

Manufacturing growth in America slowed in October. The Institute for Supply Management's index of manufacturing slipped to 51.2, from 52.9 in September, because of slackening car production and a cooling housing market. Construction spending also dropped, falling by 0.3% in September as a result of the sixth consecutive month of home-building declines.

America's core **consumer prices**, excluding food and energy, rose by 0.2% in September, an annualised rate of 2.4%. Americans' disposable income kept pace, increasing by 0.5% in current dollars in September, but consumer spending rose by only 0.1%.

The American consumer's mood was difficult to read. **Confidence** improved by more than expected, according to the final October reading of the University of Michigan's index of consumer sentiment. However, the Conference Board's measure dipped to 105.4 in October from 105.9 the previous month.

In **Germany** the value of retail sales declined by 1.7% in September, leaving it 1.2% lower than a year before. The drop happened despite expectations of higher spending in advance of a value-added tax increase coming in January.

Annual inflation in the **euro area** fell to 1.6% in October from 1.7% a month earlier thanks to lower oil prices. Meanwhile, businessmen in the euro area were feeling brighter. The European Commission's index of economic sentiment increased to 110.3 in October, a five-year high.

The unemployment rate in **Japan** rose to 4.2% in September, from 4.1% in the previous month. The jobs-to-applicants ratio remained steady with 108 jobs available for every 100 applicants. Household spending declined in September by 6% compared with a year earlier, marking the ninth consecutive month of year-on-year declines.

Japan's industrial production fell by 0.7% in September, after increasing by 1.8% in August. The drop was caused by fewer car exports and bigger inventories of digital parts.

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Output, demand and jobs

Nov 2nd 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.9	Q2	+ 1.3	+ 2.7	+ 3.2	– 3.0	Q2	+ 3.2	Q3	4.8	Sep	5.1
Austria	+ 3.0	Q2	+ 3.6	+ 2.6	+ 2.0	+ 9.1	Aug	+ 1.8	Aug	4.8	Sep	5.2
Belgium	+ 3.1	Q3	+ 2.4	+ 2.6	+ 2.0	+10.7	Aug	nil	Aug	13.0	Sep†	13.5
Britain	+ 2.8	Q3	+ 2.8	+ 2.6	+ 2.4	+ 0.7	Aug	+ 3.2	Sep	5.5	Aug‡	4.7
Canada	+ 2.9	Q2	+ 2.0	+ 2.9	+ 2.6	– 0.4	Aug	+ 3.7	Jul	6.4	Sep	6.7
Denmark	+ 2.8	Q2	+ 6.5	+ 2.7	+ 2.1	+ 4.3	Aug	+ 3.3	Sep	4.2	Sep	5.5
France	+ 2.6	Q2	+ 4.9	+ 2.3	+ 2.0	+ 1.0	Aug	+ 3.6	Aug	8.8	Sep	9.8
Germany	+ 2.4	Q2	+ 3.6	+ 2.3	+ 1.3	+ 7.3	Aug	– 1.2	Sep	10.4	Oct§	11.6
Italy	+ 1.5	Q2	+ 2.2	+ 1.6	+ 1.2	+ 3.5	Aug	– 0.7	Jul	7.0	Q2	7.8
Japan	+ 2.5	Q2	+ 1.0	+ 2.8	+ 2.1	+ 5.1	nil	+ 0.3	Aug	4.2	Sep	4.3
Netherlands	+ 2.8	Q2	+ 4.8	+ 2.7	+ 2.2	+ 0.3	Aug	+ 4.6	Jun	5.6	Sep††	6.6
Spain	+ 3.7	Q2	+ 3.8	+ 3.5	+ 2.8	+ 5.0	Aug	+ 4.1	Aug	7.8	Aug	8.6
Sweden	+ 5.1	Q2	+ 5.4	+ 4.4	+ 3.0	+ 7.0	Aug	+ 8.7	Sep	4.9	Sep†	5.4
Switzerland	+ 3.2	Q2	+ 3.0	+ 3.0	+ 2.0	+ 4.3	Q2	+ 4.5	Aug	3.1	Sep†	3.6
United States	+ 2.9	Q3	+ 1.6	+ 3.4	+ 2.4	+ 5.6	Sep	+ 4.8	Aug	4.6	Sep	5.1
Euro area	+ 2.7	Q2	+ 3.8	+ 2.5	+ 1.8	+ 5.4	Aug	+ 2.4	Aug	7.9	Aug	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 6.6	Q2	+ 7.6	na	na	+ 6.8	Sep	+ 5.5	Aug	7.9	Sep	8.3
Greece	+ 4.1	Q2	na	na	na	+ 2.3	Aug	+10.1	Aug	8.8	Q2	9.6
Iceland	+ 2.8	Q2	na	na	na	na		na		1.2	Aug†	1.8
Ireland	+ 5.0	Q2	+ 3.6	na	na	+ 5.5	Aug	+ 5.5	Aug	4.4	Sep	4.4
Luxembourg	+ 5.4	Q2	na	na	na	– 1.4	Jul	+ 2.3	Aug	4.1	Aug	4.1
New Zealand	+ 1.6	Q2	+ 1.7	na	na	+ 0.5	Q2	+ 0.9	Q2	3.6	Q2	3.7
Norway	– 0.5	Q2	+ 1.9	na	na	– 2.7	Aug	+ 8.1	Sep	3.4	Aug**	4.8
Portugal	+ 0.9	Q2	+ 3.8	na	na	+ 5.1	Aug	+ 2.1	Sep	7.3	Q2†	7.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Jun-Aug; claimant count rate 3.0% in Sep.
§EU harmonised rate 8.5% in Aug. ††Jul-Sep. **Jun-Aug.

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Prices and wages

Nov 2nd 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 3.9	Q3	+ 3.0	+ 3.4	+ 2.8	+ 7.9	Q3	+ 6.2	+ 4.7	Q2	+ 5.8
Austria	+ 1.4	Sep	+ 2.4	+ 1.8	+ 1.7	+ 2.4	Sep	+ 1.5	+ 2.7	Sep	+ 2.3
Belgium	+ 1.2	Oct	+ 2.5	+ 2.0	+ 1.9	+ 6.1	Sep	+ 1.4	+ 2.1	Jul	+ 2.5
Britain	+ 2.4	Sep*	+ 2.5	+ 2.3	+ 2.2	+ 1.8	Sep	+ 3.3	+ 4.2	Aug†	+ 4.1
Canada	+ 0.7	Sep	+ 3.4	+ 2.4	+ 2.2	+ 1.3	Sep	+ 0.9	+ 1.4	Jul	+ 0.4
Denmark	+ 1.5	Sep	+ 2.4	+ 2.0	+ 2.0	+ 2.6	Sep	+ 5.3	+ 3.2	Q2	+ 2.9
France	+ 1.2	Sep	+ 2.2	+ 2.0	+ 1.7	+ 2.7	Sep	+ 3.3	+ 3.1	Q2	+ 3.0
Germany	+ 1.2	Oct	+ 2.3	+ 1.8	+ 2.3	+ 3.0	Sep	+ 3.6	+ 0.8	Aug	+ 0.9
Italy	+ 1.8	Oct	+ 2.2	+ 2.2	+ 2.0	+ 5.4	Sep	+ 3.8	+ 3.0	Sep	+ 3.1
Japan	+ 0.6	Sep	– 0.3	+ 0.3	+ 0.5	+ 3.6	Sep	+ 1.8	+ 1.0	Sep	– 0.1
Netherlands	+ 1.1	Sep	+ 1.8	+ 1.6	+ 1.7	+ 2.8	Sep	+ 5.3	+ 2.0	Sep	+ 0.8
Spain	+ 2.9	Sep	+ 3.7	+ 3.8	+ 3.0	+ 4.2	Sep	+ 5.4	+ 3.1	Q2	+ 3.4
Sweden	+ 1.5	Sep	+ 0.6	+ 1.4	+ 1.9	+ 3.6	Sep	+ 4.2	+ 3.1	Aug	+ 3.3
Switzerland	+ 0.3	Oct	+ 1.3	+ 1.3	+ 1.3	+ 2.5	Sep	+ 1.5	+ 1.0	2005	+ 0.9
United States	+ 2.1	Sep	+ 4.7	+ 3.5	+ 2.4	+ 0.9	Sep	+ 6.9	+ 4.0	Sep	+ 2.7
Euro area	+ 1.6	Oct	+ 2.5	+ 2.2	+ 2.1	+ 5.7	Aug	+ 4.0	+ 2.4	Q2	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.5	Sep	+ 1.2	na	na	+ 5.9	Sep	+ 3.8	+ 2.9	Q2	+ 3.7
Greece	+ 2.9	Sep	+ 3.9	na	na	+ 3.6	Sep	+ 6.7	na		na
Iceland	+ 7.2	Oct	+ 4.6	na	na	+11.9	Oct	+ 4.2	+10.8	Sep	+ 6.9
Ireland	+ 4.0	Sep	+ 3.0	na	na	+ 0.1	Sep	– 0.2	+ 4.1	Q2	+ 3.5
Luxembourg	+ 2.4	Sep	+ 2.9	na	na	+ 9.3	Aug	+ 5.4	+ 2.4	Jul	+ 0.9
New Zealand	+ 3.5	Q3	+ 3.4	na	na	+ 7.8	Q2	+ 4.7	+ 3.3	Q2	+ 2.6
Norway	+ 2.6	Sep	+ 2.0	na	na	+ 5.0	Sep	+17.9	+ 3.6	Q2	+ 3.8
Portugal	+ 3.0	Sep	+ 2.8	na	na	+ 4.3	Sep	+ 4.5	+ 1.1	Aug	+ 0.5

*RPI inflation rate 3.6% in Sep. †Jun-Aug.

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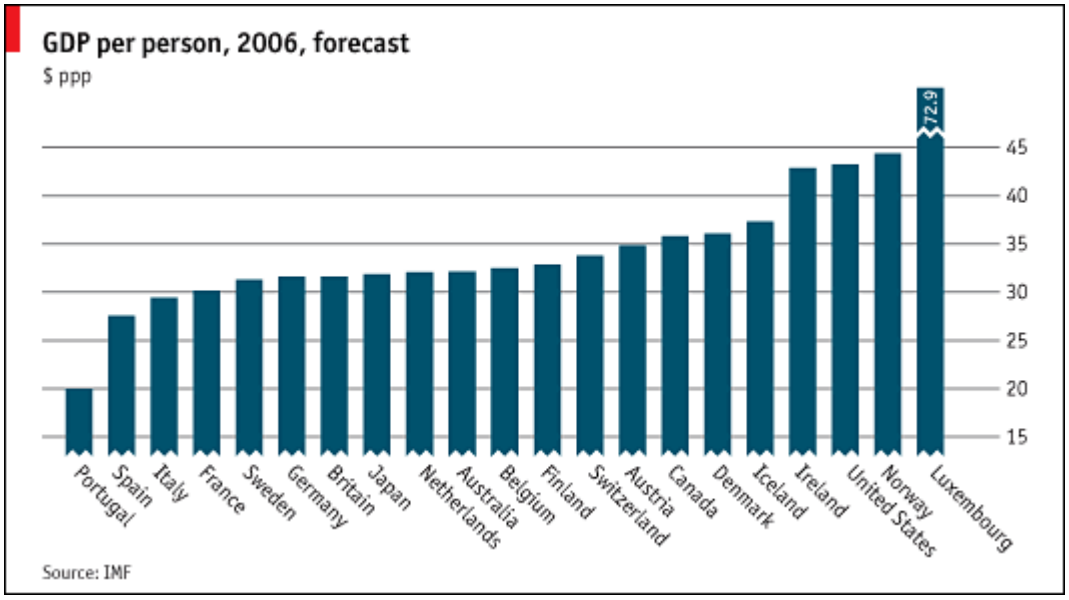
GDP per person, 2006, forecast

Nov 2nd 2006
From The Economist print edition



Luxembourg is the richest economy regularly tracked by *The Economist*. According to the IMF, its income per head will be $72,855 this year, when measured on a purchasing-power parity basis, which takes account of international differences in the price of non-traded goods. It is followed by Norway at $44,342 per head. Spain and Portugal are much poorer, with incomes per head of $27,543 and $19,949 respectively.

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Money and interest rates

Nov 2nd 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 1st 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.6	+11.2	Sep	6.38	5.65	6.10	5.63	5.45	6.81
Britain	+ 5.1	+14.5	Sep	5.16	4.55	4.91	4.50	4.35	5.53
Canada	+ 8.8	+ 7.6	Sep	4.17	3.06	3.91	3.98	4.18	5.33
Denmark	+ 8.4	+ 8.0	Sep	3.62	2.30	3.71	3.67	3.40	5.09
Japan	+ 1.5	+ 0.6	Sep	0.35	0.02	0.74	1.71	1.57	1.90
Sweden	- 0.4	+14.4	Sep	2.74	1.49	3.42	3.58	3.29	3.94
Switzerland	- 2.4	+ 1.6	Sep	1.86	0.88	2.15	2.36	2.10	2.55
United States	- 1.1	+ 4.4	Sep	5.20	4.23	4.66	4.56	4.60	5.55
Euro area†	+ 7.1	+ 8.5	Sep	3.56	2.26	3.64	3.66	3.42	4.32

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.68%, Japan No. 282 1.71%. Central bank rates: US fed funds 5.25%, ECB refinancing 3.25%, BOJ overnight call 0.25%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 2nd 2006
From The Economist print edition

2000=100

	Oct 24th	Oct 31st*	% change on one month	% change on one year
Dollar index				
All items	183.7	184.3	+ 6.8	+ 37.5
Food	148.7	147.0	+ 7.8	+ 20.1
Industrials				
All	229.2	232.5	+ 6.1	+ 56.0
Nfa†	138.7	137.0	+ 0.4	+ 2.8
Metals	278.5	284.6	+ 7.7	+ 80.4
Sterling index				
All items	148.8	146.5	+ 5.8	+ 26.9
Euro index				
All items	135.4	133.5	+ 6.6	+ 29.1
Yen index				
All items	203.7	200.4	+ 6.2	+ 38.0
Gold				
$ per oz	581.18	605.40	+ 3.9	+ 31.7
West Texas Intermediate				
$ per barrel	59.34	58.49	– 0.3	– 2.3

*Provisional. †Non-food agriculturals.

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Stockmarkets

Nov 2nd 2006
From The Economist print edition

Market indices

	Nov 1st	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,383.6	5,383.6	4,708.8	+ 1.1	nil	+14.3	+20.8
Austria (ATX)	4,098.3	4,344.4	3,324.1	- 0.5	- 5.7	+11.8	+21.1
Belgium (Bel 20)	4,166.0	4,185.2	3,445.1	- 0.2	- 0.5	+17.4	+27.1
Britain (FTSE 100)	6,149.6	6,214.6	5,506.8	- 1.0	- 11.3	+ 9.4	+21.6
Canada (Toronto Composite)	12,050.4	12,487.3	10,904.3	- 2.4	- 3.5	+ 6.9	+10.5
Denmark (OMXCB)	398.3	400.5	325.0	- 0.6	- 0.6	+ 8.3	+17.3
France (SBF 250)	3,793.7	3,831.2	3,244.2	- 0.7	- 13.6	+14.9	+24.5
France (CAC 40)	5,370.9	5,433.8	4,615.4	- 0.9	- 22.4	+13.9	+23.4
Germany (DAX)*	6,291.9	6,291.9	5,292.1	+ 0.4	- 22.0	+16.3	+26.0
Italy (S&P/MIB)	39,753.0	39,753.0	34,850.0	+ 0.9	- 20.7	+11.3	+20.6
Japan (Nikkei 225)	16,375.3	17,563.4	14,218.6	- 1.9	- 57.9	+ 1.6	+ 2.5
Japan (Topix)	1,622.5	1,783.7	1,458.3	- 1.9	- 43.8	- 1.7	- 0.8
Netherlands (AEX)	486.1	493.4	412.9	- 1.4	- 30.7	+11.3	+20.5
Spain (Madrid SE)	1,503.6	1,503.6	1,156.8	+ 1.1	nil	+30.0	+40.9
Sweden (Affarsvarlden Gen)	342.7	344.6	275.2	- 0.5	- 14.4	+16.8	+29.1
Switzerland (Swiss Market)	8,613.0	8,697.6	7,154.9	- 0.8	- 1.0	+13.6	+20.4
United States (DJIA)	12,031.0	12,163.7	10,667.4	- 0.9	- 1.1	+12.3	+12.3
United States (S&P 500)	1,367.8	1,389.1	1,223.7	- 1.0	- 10.5	+ 9.6	+ 9.6
United States (NASDAQ Comp)	2,334.4	2,379.1	2,020.4	- 0.9	- 53.8	+ 5.9	+ 5.9
Europe (FTSEurofirst 300)†	1,449.3	1,454.7	1,238.7	- 0.4	- 15.0	+13.6	+23.1
Euro area (FTSE Euro 100)†	1,239.0	1,242.1	1,050.0	- 0.1	- 20.1	+13.8	+23.2
World (MSCI)‡	1,419.3	1,430.0	1,243.9	- 0.1	- 2.0	+12.8	+12.8
World bond market (Citigroup)††	654.2	654.2	612.1	+ 2.3	- 1.9	+ 5.5	+ 5.5

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Nov 2nd 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Nov 1st	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Nov 1st	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 9.6 Sep	− 41.0 Q2	− 5.6	− 5.3	120.0	116.8	1.29	1.35	2.46	1.65	1.10	+ 0.9
Austria	− 1.8 Aug	+ 9.2 Q2	+ 0.8	+ 0.8	105.8§	105.1	0.78	0.83	1.49	–	0.67	− 1.9
Belgium	+ 15.9 Aug	+ 6.5 Jun	+ 1.8	+ 2.0	107.6§	106.8	0.78	0.83	1.49	–	0.67	− 0.4
Britain	−142.0 Aug	− 64.4 Q2	− 2.7	− 3.0	102.8	99.4	0.52	0.56	–	0.67	0.45	− 3.4
Canada	+ 57.8 Aug	+ 28.6 Q2	+ 1.5	+ 1.0	127.4	122.9	1.13	1.18	2.16	1.44	0.97	+ 2.2
Denmark	+ 7.9 Aug	+ 7.0 Aug	+ 1.9	+ 1.8	106.5	106.1	5.84	6.19	11.1	7.46	4.99	+ 3.3
France	− 35.0 Aug	− 39.8 Aug	− 1.8	− 1.4	108.5§	107.5	0.78	0.83	1.49	–	0.67	− 2.9
Germany	+185.9 Aug	+105.5 Aug	+ 3.6	+ 3.6	110.2§	108.9	0.78	0.83	1.49	–	0.67	− 3.1
Italy	− 25.5 Aug	− 34.6 Aug	− 1.8	− 1.7	108.1§	107.1	0.78	0.83	1.49	–	0.67	− 4.2
Japan	+ 78.9 Aug	+166.9 Aug	+ 3.5	+ 3.5	79.9	82.1	117	117	223	149	–	− 5.2
Netherlands	+ 38.2 Aug	+ 46.2 Q2	+ 6.3	+ 6.0	108.5§	107.5	0.78	0.83	1.49	–	0.67	− 0.5
Spain	−106.4 Aug	− 97.1 Jul	− 8.4	− 8.0	105.9§	105.3	0.78	0.83	1.49	–	0.67	+ 1.1
Sweden	+ 19.1 Sep	+ 24.1 Q2	+ 6.5	+ 6.0	98.6	93.0	7.20	7.98	13.7	9.20	6.16	+ 1.7
Switzerland	+ 8.8 Sep	+ 55.3 Q2	+13.0	+12.5	105.0	107.3	1.24	1.28	2.37	1.59	1.06	− 0.2
United States	−850.9 Aug	−838.1 Q2	− 6.6	− 6.6	83.7	86.8	–	–	1.91	1.28	0.85	− 3.6
Euro area	− 24.6 Aug	− 44.1 Aug	− 0.4	− 0.2	118.6	116.2	0.78	0.83	1.49	–	0.67	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 11.1 Aug	+ 11.8 Aug	na	na	109.2§	108.3	0.78	0.83	1.49	–	0.67	+ 2.2
Greece	− 40.5 Aug	− 26.1 Aug	na	na	105.0§	104.3	0.78	0.83	1.49	–	0.67	− 3.0
Iceland	− 1.9 Sep	− 3.4 Q2	na	na	85.6**	100.9	67.6	59.5	129	86.4	57.8	+ 2.0
Ireland	+ 37.4 Aug	− 6.0 Q2	na	na	113.9§	112.4	0.78	0.83	1.49	–	0.67	− 0.3
Luxembourg	− 5.4 Aug	+ 4.2 Q2	na	na	107.6§	106.8	0.78	0.83	1.49	–	0.67	− 1.7
New Zealand	− 4.1 Sep	− 10.2 Q2	na	na	131.6	138.8	1.48	1.44	2.82	1.89	1.27	+ 4.6
Norway	+ 59.8 Sep	+ 56.5 Q2	na	na	106.1	112.7	6.47	6.46	12.3	8.27	5.53	+ 18.5
Portugal	− 22.5 Jul	− 16.4 Aug	na	na	105.9**	105.0	0.78	0.83	1.49	–	0.67	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

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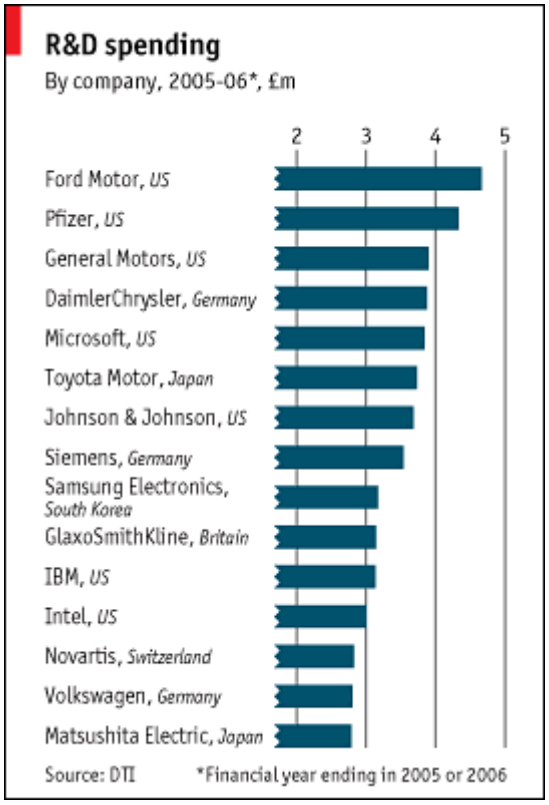
R&D spending

Nov 2nd 2006
From The Economist print edition



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Overview

Nov 2nd 2006
From The Economist print edition

Indonesia has finally shaken off the inflationary effects of cutting fuel subsidies on October 1st 2005. Consumer prices rose by 6.3% in the year to October 2006, after rising by 14.5% in the year to September.

In **South Korea**, annual inflation fell to 2.1% in October. Its industrial production surged by 16.3% in the year to September. **Thailand**'s rose by 5% over the same period.

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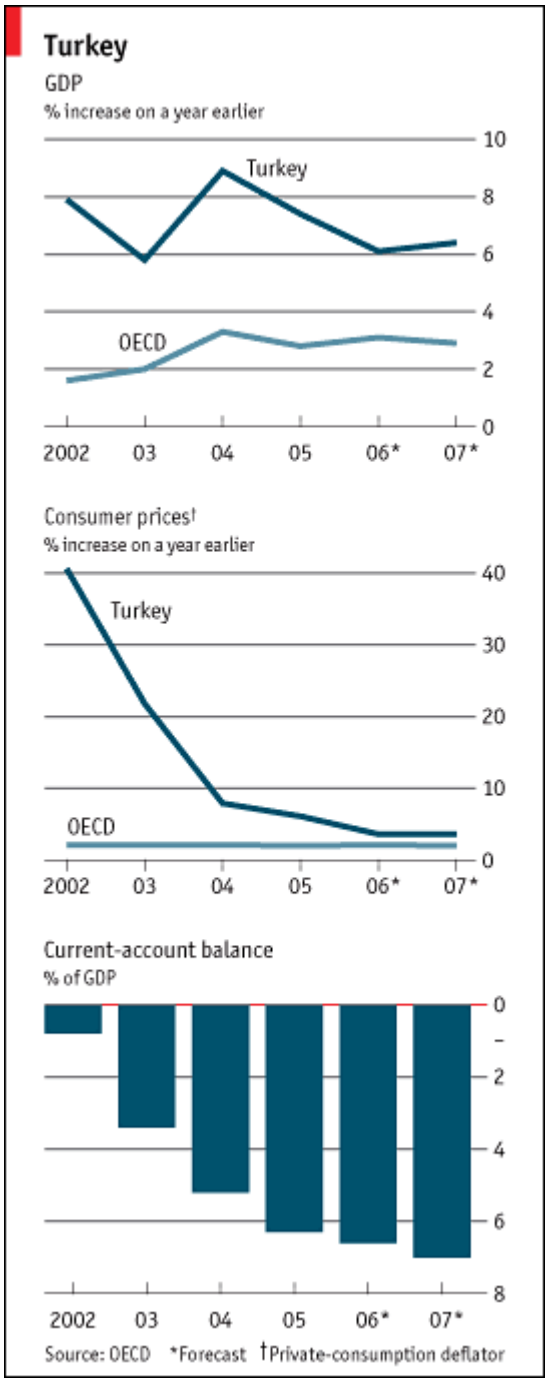
Turkey

Nov 2nd 2006
From The Economist print edition

Turkey is still reeling from the “inflation shock” it suffered in the spring, says the OECD's latest survey. Despite the central bank's best efforts, Turks now expect it to miss its inflation target of 4% for some time. Quelling inflation would be easier if Turkey's product markets were more competitive and its labour market less rigid, the report notes. It also urges the government to do its bit, by acting on its promise to cap spending.



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Economy

Nov 2nd 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+10.4	Q3	+16.1	Sep	+ 1.5	Sep	+143.6	Sep	+160.8	2005	987.9	Sep
Hong Kong	+ 5.2	Q2	+ 5.3	Q2	+ 2.1	Sep	−15.9	Sep	+18.6	Q2	130.3	Sep
India	+ 8.9	Q2	+ 9.7	Aug	+ 6.8	Sep	−42.0	Sep	−13.2	Q2	158.3	Sep
Indonesia	+ 5.2	Q2	+ 6.2	Aug	+ 6.3	Oct	+37.0	Sep	+ 4.1	Q2	40.8	Sep
Malaysia	+ 5.9	Q2	+ 5.0	Aug	+ 3.3	Sep	+28.0	Aug	+20.0	Q2	79.3	Sep
Pakistan	+ 6.6	2006†	+13.0	Jul§	+ 8.7	Sep	−12.6	Aug	− 5.0	Q2	11.3	Aug
Philippines	+ 5.5	Q2	− 7.0	Aug	+ 5.7	Sep	− 4.1	Aug	+ 4.3	Jun	18.8	Sep
Singapore	+ 7.1	Q3	+ 7.6	Sep	+ 0.4	Sep	+33.7	Sep	+38.3	Q2	129.4	Sep
South Korea	+ 4.6	Q3	+16.3	Sep	+ 2.1	Oct	+14.9	Oct	+ 6.9	Sep	229.5	Oct
Taiwan	+ 4.6	Q2	+ 2.1	Sep	− 1.2	Sep	+21.7	Sep	+20.6	Q2	261.6	Sep
Thailand	+ 4.9	Q2	+ 5.0	Sep	+ 2.8	Oct	− 1.2	Sep	+ 3.7	Sep	60.0	Sep
Argentina	+ 7.9	Q2	+ 6.6	Sep	+10.4	Sep	+11.5	Sep	+ 7.4	Q2	26.3	Aug
Brazil	+ 1.2	Q2	+ 3.2	Aug	+ 3.7	Sep	+46.5	Oct	+13.3	Sep	70.8	Sep
Chile	+ 4.5	Q2	− 2.6	Sep	+ 2.8	Sep	+20.0	Sep	+ 2.2	Q2	17.6	Sep
Colombia	+ 6.0	Q2	+12.5	Aug	+ 4.2	Oct	+ 0.7	Jul	− 2.2	Q2	14.9	Sep
Mexico	+ 4.7	Q2	+ 5.8	Aug	+ 4.1	Sep	− 5.3	Sep	− 0.6	Q2	83.6	Aug
Peru	+ 9.2	Aug	+ 9.9	Aug	+ 2.0	Sep	+ 7.4	Aug	+ 1.3	Q2	14.5	Sep
Venezuela	+ 9.2	Q2	+ 7.8	Jul	+ 8.7	Oct	+37.2	Q2	+29.5	Q2	27.6	Aug
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 9.6	Sep	−11.2	Q1	+ 2.1	Q1	22.9	Sep
Israel	+ 6.2	Q2	+ 8.1	Aug	+ 1.3	Sep	− 7.5	Sep	+ 5.8	Q2	27.8	Sep
Saudi Arabia	+ 6.6	2005‡	na		+ 2.2	Jul	+126.5	2005	+90.7	2005	25.4	Aug
South Africa	+ 3.6	Q2	+ 4.2	Aug	+ 5.3	Sep	− 7.6	Sep	−13.3	Q2	22.3	Sep
Czech Republic	+ 6.2	Q2	+ 7.4	Aug	+ 2.7	Sep	+ 1.7	Aug	− 3.8	Q2	30.4	Sep
Hungary	+ 3.8	Q2	+ 9.0	Aug	+ 5.9	Sep	− 3.1	Aug	− 7.6	Q2	20.9	Sep
Poland	+ 5.5	Q2	+11.7	Sep	+ 1.6	Sep	− 3.6	Aug	− 6.6	Aug	46.7	Sep
Russia	+ 7.4	Q2	+ 4.1	Sep	+ 9.6	Sep	+142.3	Aug	+101.4	Q3	258.7	Sep
Turkey	+ 7.5	Q2	+ 4.8	Aug	+10.6	Sep	−51.4	Sep	−30.1	Aug	58.0	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+12.0	Q2	+ 1.8	Sep	+ 3.8	Sep	− 2.9	Jul	− 1.9	Aug	2.3	Aug
Latvia	+10.9	Q2	+ 7.6	Aug	+ 5.9	Sep	− 4.1	Aug	− 3.1	Aug	3.9	Aug
Lithuania	+ 6.3	Q3	na		+ 3.2	Sep	− 4.4	Aug	− 2.6	Aug	4.1	Aug
Slovakia	+ 6.2	Q2	+13.7	Aug	+ 4.6	Sep	− 3.1	Aug	− 4.4	Jun	12.5	Aug
Slovenia	+ 4.9	Q2	+10.9	Aug	+ 2.5	Sep	− 1.8	Aug	− 0.7	Aug	7.7	Jul

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Nov 2nd 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 1st		Dec 30th 2005	
	Nov 1st	year ago	Nov 1st	% a year		one week	in local currency	in $ terms
China	7.87	8.09	15.0	3.00	1,949.8	+2.7	+ 59.7	+ 63.7
Hong Kong	7.78	7.75	14.8	4.01	18,453.7	+1.6	+ 24.0	+ 23.7
India	44.9	45.2	85.6	6.63	13,033.0	+3.2	+ 38.7	+ 39.1
Indonesia	9,103	10,058	17,358	10.77	1,589.9	+1.1	+ 36.7	+ 47.8
Malaysia	3.65	3.78	6.96	3.78	989.3	+1.0	+ 10.0	+ 13.9
Pakistan	60.6	59.7	116	10.29	11,011.1	-4.8	+ 15.2	+ 13.6
Philippines	49.8	54.7	95.0	7.75	2,708.5	+1.1	+ 29.2	+ 37.5
Singapore	1.56	1.69	2.97	3.50	2,737.8	+0.9	+ 16.6	+ 24.4
South Korea	939	1,040	1,791	4.60	1,374.4	+0.2	- 0.4	+ 7.2
Taiwan	33.2	33.6	63.3	1.84	7,014.0	- 0.7	+ 7.1	+ 6.0
Thailand	36.7	40.9	69.9	5.25	730.9	- 0.3	+ 2.4	+ 14.5
Argentina	3.09	2.99	5.89	10.13	1,794.4	+9.1	+ 16.3	+ 14.0
Brazil	2.14	2.24	4.08	13.68	39,930.0	+10.6	+ 19.4	+ 30.3
Chile	526	547	1,003	5.16	11,069.5	+4.0	+ 20.2	+ 17.1
Colombia	2,303	2,292	4,392	6.68	10,374.9	+13.7	+ 9.1	+ 8.3
Mexico	10.7	10.8	20.5	7.23	23,042.3	+5.9	+ 29.4	+ 28.2
Peru	3.22	3.37	6.13	4.41	10,694.5	+3.4	+122.7	+137.5
Venezuela	2,959§	2,794§	5,643	10.03	38,151.4	+9.2	+ 87.1	+ 63.5
Egypt	5.73	5.76	10.93	9.42	58,962.3	+2.8	+ 6.5	+ 6.6
Israel	4.27	4.65	8.14	5.16	916.6	+2.4	+ 10.7	+ 19.4
Saudi Arabia	3.75	3.75	7.15	5.23	9,328.5	-11.5	- 44.2	- 44.2
South Africa	7.36	6.65	14.0	8.65	23,600.5	+0.5	+ 30.4	+ 12.4
Czech Republic	22.0	24.5	41.9	2.68	1,553.3	- 0.6	+ 5.5	+ 18.3
Hungary	203	207	387	8.21	22,391.4**	- 1.1	+ 7.7	+ 13.6
Poland	3.02	3.28	5.76	4.21	47,358.1	- 1.2	+ 33.0	+ 43.4
Russia	26.7	28.5	50.9	11.00	1,644.9‡	+0.9	+ 35.8	+ 46.1
Turkey	1.45	1.35	2.77	19.58	40,601.7	+2.4	+ 2.1	- 5.0
EM (MSCI)*	1.00	1.00	1.91	na	822.1	+5.9	+ 16.4	+ 16.4
EMBI+†	1.00	1.00	1.91	na	400.2	+2.3	+ 8.6	+ 8.6

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Trading market value. **Oct 31st.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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